# 2023 MTBPS

# ANNEXURES

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

# A

## 2023 MTBPS

# FISCAL RISK STATEMENT

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## INTRODUCTION

This fiscal risk statement considers the major medium- and long-term risks to the public finances. It should be read in conjunction with the analysis of short-term risks presented in Chapter 3. The primary risks to the fiscal outlook over the next decade are lower potential growth, difficulty in executing government's borrowing strategy, and spending pressures – particularly in subnational government and state-owned companies. The fiscal risk statement also considers the sustainability of government's social commitments in the context of low economic growth.

## MACROECONOMIC RISKS

As discussed in Chapter 2, the economic growth outlook has deteriorated. If GDP growth underperforms the forecast, it may compromise government's ability to achieve its fiscal goals. Additional deviations from planned spending will raise the sovereign risk premium and make fiscal stabilisation harder to achieve.

**Figure A.1 Nominal GDP growth**

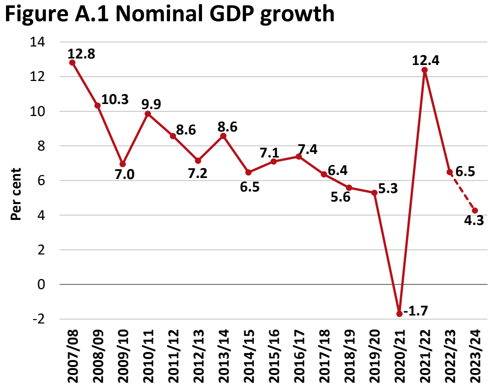
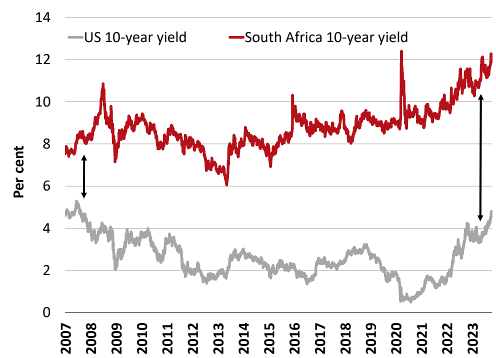



**Figure A.2 Government bond yields**




*Source: National Treasury and Bloomberg*

South Africa's long-term debt dynamics are unfavourable over the medium-term horizon. The gap between the yield on South Africa's long-term debt and the yield on the United States 10-year Treasury bond has widened consistently since 2015. This reflects an increase in South Africa's risk premium – the additional amount that government pays investors to compensate for uncertainty. Should the combination of weaker nominal growth and rising yields persist, it will require consistently higher primary surpluses – where revenue exceeds non-interest expenditure – to stabilise the public finances over the long term. As outlined in chapters 2 and 3, government's fiscal strategy is intended to reduce fiscal risks and support economic growth.

### Fiscal scenarios

By considering different macroeconomic scenarios that deviate from the baseline forecast, policymakers can better anticipate potential challenges and navigate the complexities of a shifting economic environment. The 2023 *Medium Term Budget Policy Statement* (MTBPS) considers the fiscal implications of the two scenarios outlined in Chapter 2:

**Scenario A – Economic growth slows appreciably in China**. The primary balance deteriorates by R48.6 billion compared with the baseline forecast. Debt-service costs remain above 20 per cent of revenue for the foreseeable future. By 2027/28, debt stabilises at 79.8 per cent of GDP and declines thereafter.

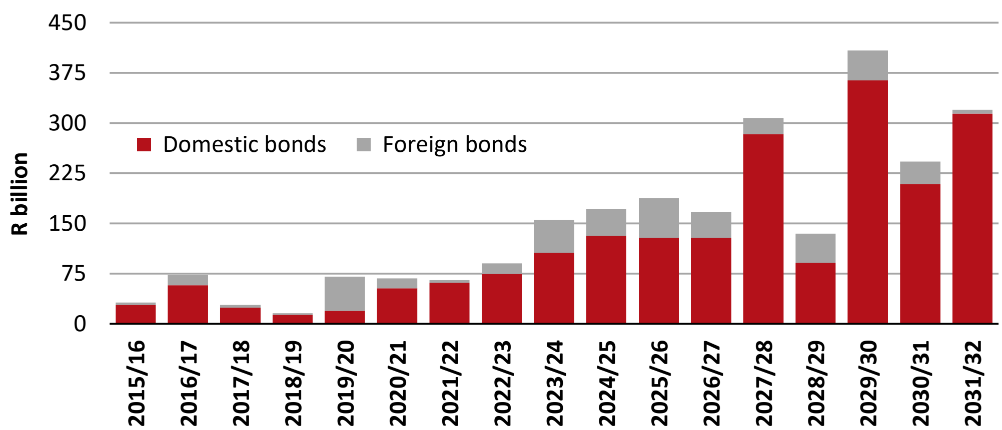
**Scenario B – Global disinflation**. The primary balance improves more rapidly relative to the 2023 MTBPS baseline projection. Debt-service costs fall below 20 per cent of revenue by 2030/31 and the debt-to-GDP ratio stabilises at 76.3 per cent of GDP in 2025/26 and declines thereafter.

## DEBT MANAGEMENT RISKS

Government debt levels are affected by the budget balance and changes in economic variables such as interest, inflation and exchange rates. Between 2007/08 and 2022/23, government's debt stock grew from R577 billion to R4.77 trillion.

Government's fiscal consolidation efforts focus on reducing the persistent gaps between revenue and expenditure, which will improve the primary balance. In addition to the primary balance, government debt stock and redemptions are important indicators of macro-fiscal health. The large debts that government incurred to finance the budget balance need to be repaid or refinanced as they become due. Figure A.3 shows the extent of debt redemptions to 2031/32. Over the next eight years, debt redemptions will average R242.5 billion annually.

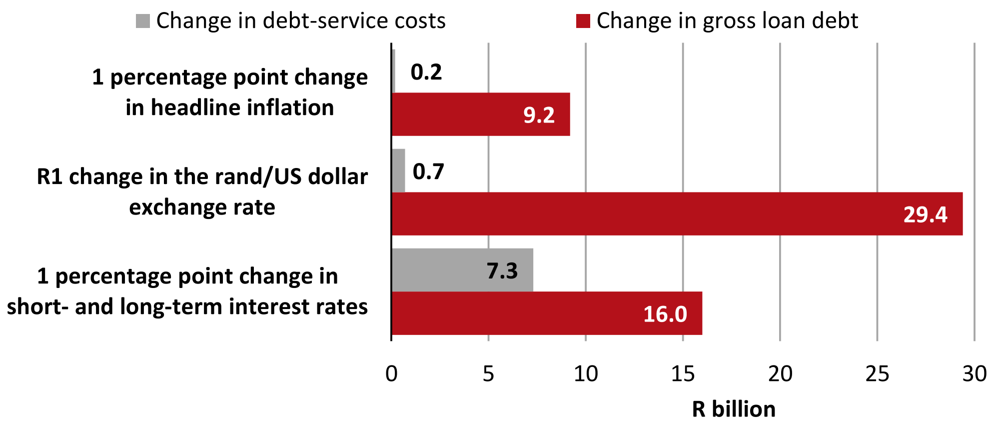
**Figure A.3 Long-term government debt redemptions**




*Source: National Treasury*

High debt levels elevate the risks associated with changes in macroeconomic variables such as interest, inflation and exchange rates, which affect debt and debt-service costs. Modelling by the National Treasury shows that a 1 percentage point increase in inflation and interest rates, together with a R1 depreciation of the rand's exchange value against the US dollar, results in a R54.6 billion increase in gross loan debt and an R8.2 billion increase in debt-service costs. Successful fiscal consolidation will reduce these risks by reducing the deficit and stabilising the stock of debt.

**Figure A.4 Sensitivity of debt and debt-service costs**




*Source: National Treasury*

Government continues to manage debt in a prudent and sustainable manner within its strategic risk benchmarks by diversifying the debt portfolio and managing refinancing risk.

## SUBNATIONAL GOVERNMENT

Relative to the previous year, provincial accruals increased by 7.8 per cent in 2022/23 to R18.2 billion. Provincial medico-legal payments rose from R996 million in 2021/22 to R1.6 billion in 2022/23. Government estimates the total contingent liabilities associated with such claims at R76 billion in 2022/23, down from R86.5 billion in 2021/22.

Local government arrears increased from R89.7 billion in 2021/22 to R99.9 billion in 2022/23. Over the same period, uncollected revenues grew from R255.4 billion to R313.2 billion. Monies owed to Eskom, the Department of Water and Sanitation and the water boards increased from R63.5 billion in 2021/22 to R88 billion at the end of June 2023. The agreement to write off part of municipal debt to Eskom, discussed in Chapter 4, is expected to mitigate some of the risk of this outstanding debt.

## CONTINGENT LIABILITIES

Contingent liabilities represent government's potential financial commitments if certain conditions occur. The bulk of contingent liabilities are associated with the poor financial condition of state-owned companies. In recent years, some of these liabilities have materialised, straining the fiscal framework.

Government's guarantee portfolio decreased from R751.9 billion in March 2022 to R663.9 billion in March 2023. Guarantees to state-owned companies decreased from R543.6 billion in March 2022 to R448.1 billion in March 2023, mostly due to a decline in the Reserve Bank loan guarantee scheme from R100 billion to R20 billion. Eskom constitutes 84 per cent of the exposure, although Eskom's guarantee framework agreement expired on 31 March 2023. The guarantee to Denel has also expired and no new guarantees were issued to state-owned companies during the current year.

From October 2023, Cabinet members requesting fiscal commitments that affect contingent liabilities will report these to Parliament on a quarterly basis. Government is managing its exposure to contingent liabilities carefully in the context of past experience with large appropriations to state-owned companies and the current Eskom debt-relief arrangement.

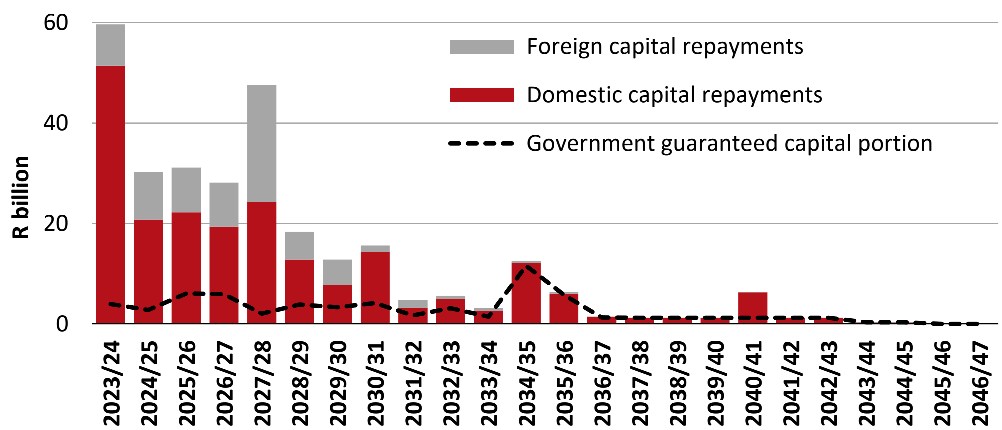
Rapid implementation of the structural reforms outlined in Chapter 2, supported by a government policy outlining a strategic approach to managing state-owned companies, will be crucial in managing these contingent liabilities.

## FINANCIAL CONDITION OF STATE-OWNED COMPANIES

Since 2019, weak economic growth has compounded the poor financial position of most state-owned companies. Capital investment continues to slow, falling below company budgets, with some large enterprises facing serious liquidity problems. Operational inefficiencies, high cost structures and onerous debt obligations continue to hamper profitability and cash flows, intensified by non-payment for services. Many companies are unable to attract funding at favourable rates and terms, and rely on fiscal funding for support.

Figure A.5 shows the debt maturity profile of the largest state-owned companies.

**Figure A.5 Debt maturity profile of the largest state-owned companies***




**Airports Company South Africa, Denel, Development Bank of Southern Africa, Industrial Development Corporation, Land Bank, South African Airways, South African National Roads Agency Limited and Trans-Caledon Tunnel Authority; excludes Eskom*
*Source: National Treasury as at 31 March 2023*

Over the medium term, repayments are expected to amount to R121 billion. The large domestic capital repayment in 2023/24 stems from the maturity of bonds issued by the Industrial Development Corporation, the Development Bank of Southern Africa, Transnet and the South African National Roads Agency Limited (SANRAL). In the following three years, capital repayments will be relatively lower as state-owned companies build cash flows to manage maturities. Capital repayments are expected to decline significantly after another spike in 2027/28.

### Denel

Denel remains in financial distress and has not submitted its annual financial statements since 2019/20. In March 2023, government disbursed R1.9 billion to Denel through the Special Appropriation Act (2022). The disbursement was proportionate to the entity’s share of proceeds from the sale of non-core assets. Denel used this funding to help settle debt obligations, pay for restructuring and enhance working capital. The remaining portion remains ringfenced until other non-core assets are sold. In September 2023, Denel requested that a further R100 million of the ringfenced funds be released to settle the last government guaranteed debt obligation. Following its settlement, Denel has no debt obligations remaining and its government guarantee will be revoked.

## Eskom

As outlined in the 2023 Budget, government is providing Eskom with debt relief amounting to R254 billion from 2023/24 to 2025/26, subject to strict conditions. This arrangement will enable the utility to undertake much-needed maintenance and investment, and to improve its financial position. Eskom's financial sustainability remains at risk from poor generating plant performance, declining sales, lack of cost-reflective tariffs, rising municipal arrears and high debt-service costs.

The Eskom Debt Relief Act (2023) was promulgated in July 2023. Eskom is required to comply with strict conditions attached to this act until 31 March 2026. As at 30 September 2023, government has already disbursed R16 billion of the R78 billion for 2023/24. A task team has been established with officials from the National Treasury, the Department of Public Enterprises and Eskom to monitor compliance with the conditions and report quarterly on whether Eskom qualifies for the conversion of the loan to equity.

Chapter 2 discusses the near-term risk to growth posed by Eskom. Prolonged power cuts would continue to constrain the economy, with significant knock-on effects for the public finances.

## The Land Bank

The Land Bank remains in default after failing to meet its debt obligation in April 2020. At the end of 2022/23, the National Treasury transferred R5.1 billion to the Land Bank, subject to conditions, as part of a R7 billion fiscal allocation. Government has repaid approximately R1.4 billion to all guaranteed lenders of the Land Bank since its default, eliminating its guarantee exposure. The remaining portion of the R7 billion fiscal allocation will be transferred to the Land Bank in this financial year to use in its blended finance scheme during March 2024.

## Transnet

Transnet continues to experience weak profitability and deteriorating liquidity due to operational challenges, a high debt burden and low cash flows. A prolonged period of underinvestment in capital infrastructure and maintenance backlogs have combined to limit revenue-generating capacity. Transnet has initiated a five-year R122.7 billion capital investment programme, including R99.5 billion for operational maintenance and R23.2 billion to expand infrastructure, starting in 2023/24. Further borrowing is restricted by its existing debt, which stood at R130 billion at the end of March 2023, and declining revenues. Transnet's issued guarantee remains at R3.5 billion.

## South African National Roads Agency Limited

A long-term dispute over Phase 1 of the Gauteng Freeway Improvement Programme has limited SANRAL's investment capacity. Government's decision to take over the Phase 1 commitments will support SANRAL's ability to finance the strengthening, rehabilitation and expansion of the toll road network. As a result of revisions to SANRAL's borrowing limits and guarantees associated with the R23 billion injection made in the 2022 Adjustments Budget, SANRAL will now seek approval to revise its funding plan to ensure continued investment in the national road network.

## LONG-TERM SUSTAINABILITY OF SOCIAL COMMITMENTS

The National Treasury maintains a long-term fiscal model to evaluate the sustainability of existing and new expenditure commitments, factoring in updated economic and demographic growth assumptions. The current update excludes results from the Census 2022, which will be analysed in an update in the 2026 MTBPS. This update highlights two adjustments to the assumptions following the COVID-19 pandemic:

- Demographic changes due to a high number of deaths, and lower migration and fertility.
- Subdued long-run economic growth.

The model is highly sensitive to any alterations in assumptions, including sector-specific cost trajectories and existing policy considerations. In the baseline model, nominal GDP growth (Figure A.7) is projected to decelerate over the medium term and reaches a long-term value of 6.8 per cent. Inflation remains stable at about 4.5 per cent. The nominal yield on government debt gradually decreases from 11.9 per cent in 2023/24 to 9.2 per cent by 2031/32.

Spending on key government programmes is broadly sustainable over the long term, largely because projected consolidated government spending has fallen relative to 2021 projections – due in part to efforts to contain the public-service wage bill. Demographic changes have also contributed to the sustainability of government spending.

**Figure A.6 Statistics South Africa mid-year population growth estimates**

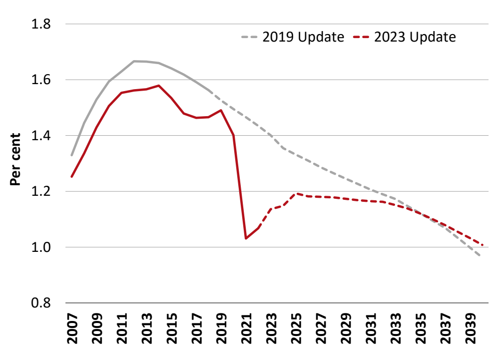
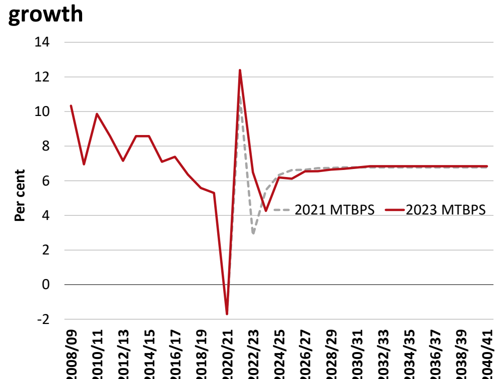



**Figure A.7 Revisions to long-term nominal GDP growth**




*Source: Statistics South Africa and National Treasury*

### Social assistance

The 2019 MTBPS noted that by 2040/41, social assistance beneficiaries – excluding the temporary *COVID-19 social relief of distress grant* – were projected to increase to 22.5 million, necessitating spending on social grants amounting to 3 per cent of GDP annually. This is in line with current grants spending, excluding the temporary grant. If that or a similar type of new grant is made permanent, beneficiaries are projected to expand from 27.3 million in 2023/24 to 40.4 million in 2040/41, which will cost 3.8 per cent of GDP in 2040/41 and require a corresponding permanent source of funding, such as additional revenue measures.

### Basic education

Over the past decade, spending on basic education has consistently hovered around 4.5 per cent of GDP. While teacher remuneration increased by an annual average of 7.5 per cent over the period, the number of teachers has declined, leaving spending relatively stable. As higher-earning older educators retire, the real wage bill for teachers is likely to decline. By 2040/41, basic education spending of about 4.6 per cent of GDP is projected to maintain current class sizes. This stabilisation is attributed to a combination of modest growth in the youth population and younger educator demographics.[1]

### Health

Long-term healthcare expenditure is largely determined by inflation in the health sector and the growing needs of the population. Health inflation has lagged behind consumer price index inflation by an annual average of 0.4 percentage points over the past decade. Visits to public institutions grew by an annual average of 2.6 per cent between 2007/08 and 2014/15, but declined by an annual average of 1.1 per cent from 2015/16 to 2019/20 – and more sharply in 2020/21 due to COVID-19. If the national health insurance policy is implemented, then spending on public health could increase from about 4 per cent of GDP in 2022/23 to 6 per cent of GDP by 2040/41. This increase may require additional spending or revenue measures to ensure sustainability.

### Higher education

Over the past 10 years, inflation in the higher education sector has consistently exceeded consumer price index inflation by about 2 percentage points. If this trend persists and the number of students grows in line with the working age population, current National Student Financial Aid Scheme funding levels for university students will increase. Funding requirements will increase from 1.3 per cent of GDP in 2022/23 to 1.5 per cent of GDP in 2040/41. However, if funding per student grows in line with headline inflation, the funding requirement will remain stable. Similarly, assuming enrolment of about 670 000 students annually, expenditure in the technical and vocational education and training sector is expected to remain constant at 0.2 per cent of GDP during the same period.

## CONCLUSION

The outlook for the public finances is vulnerable to a range of domestic and external risks. The fiscal strategy outlined in the 2023 MTBPS helps government gradually build fiscal buffers to mitigate the risks outlined in this annexure. Disciplined measures across the public sector are also required to manage and mitigate these risks.

[1] Gustafsson, M. 2022. Projections of educators by age and average cost to 2070.

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