RISK, RENEWAL AND GROWTH

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

2030 NDP

Main messages in Budget 2019

- The 2019 Budget outlines a series of economic and fiscal measures intended to move the economy onto a new trajectory and reduce the long-term risks to South Africa's public finances
- Government's central economic policy goal is to accelerate inclusive growth and create jobs. Its main fiscal objective is to ensure sustainable finances by containing the budget deficit and stabilising public debt. The Budget proposals support these goals
- This budget confronts a difficult environment in which economic growth remains weak, public debt and debt-service costs have accelerated, and governance and operational concerns are manifest across the public sector
- Weak economic performance and residual problems in tax administration have resulted in large revenue shortfalls. The deteriorating financial position of state-owned companies has put additional pressure on the public finances
- In light of these considerations, the 2019 Budget priorities are to:
  - Narrow the budget deficit and stabilise the national debt-to-GDP ratio
  - Support restructuring of the electricity sector, and reduce the immediate risks Eskom poses to the economy and the public finances
  - Renew economic growth by strengthening private-sector investment, improving the planning and implementation of infrastructure projects, and rebuilding state institutions

Global growth outlook has slowed

Economic growth in selected countries

Region/country	2010-2017	2018	2019	2020	2021-2023
Percentage	Post-crisis		Average GDP forecast		
World	**3.8**	**3.7**	**3.5**	**3.6**	**3.6**
Advanced economies	**2.0**	**2.3**	**2.0**	**1.7**	**1.6**
United States	2.2	2.9	2.5	1.8	1.5
Euro area	1.3	1.8	1.6	1.7	1.5
United Kingdom	2.0	1.4	1.5	1.6	1.6
Japan	1.5	0.9	1.1	0.5	0.5
Developing countries	**5.3**	**4.6**	**4.5**	**4.9**	**4.9**
China	8.0	6.6	6.2	6.2	5.8
India	7.3	7.3	7.5	7.7	7.7
Brazil	1.4	1.3	2.5	2.2	2.2
Russia	1.8	1.7	1.6	1.7	1.4
Mexico	3.1	2.1	2.1	2.2	2.9
Sub-Saharan Africa	**4.3**	**2.9**	**3.5**	**3.6**	**4.0**
South Africa[1]	2.0	0.7	1.5	1.7	2.4

1. National Treasury forecast

Source: IMF World Economic Outlook, January 2019 and IMF World Economic Outlook database

- GDP growth projections for the United States, China and Europe have been revised down
- Financial market conditions, which stabilised in the middle of last year, have become more volatile since the end of 2018
- Short-term uncertainty has added to concerns about trade tensions and slower global growth

GDP outlook has been revised down since the 2018 MTBPS

Macroeconomic outlook

	2018	2019	2020	2021
Real percentage growth	**Estimate**		**Forecast**	
Household consumption	1.5	1.5	2.0	2.3
Gross fixed-capital formation	-0.2	1.5	2.1	3.0
Exports	2.0	2.3	2.7	2.8
Imports	3.8	1.7	3.2	3.3
Real GDP growth	**0.7**	**1.5**	**1.7**	**2.1**
Consumer price index (CPI) inflation	4.7	5.2	5.4	5.4
Current account balance (% of GDP)	-3.5	-3.4	-3.8	-4.0

- Real GDP growth estimated at 1.5 per cent in 2019, down from 1.7 per cent in the 2018 MTBPS, reflecting weak employment and investment growth
- CPI inflation is projected at 5.2 per cent in 2019 in response to rising food inflation and electricity prices
- CPI inflation projections for 2020 and 2021 remain unchanged from 2018 MTBPS estimates

Progress on restoring confidence and supporting growth

- Progress has been made on growth-enhancing reforms, including preparations to allocate telecommunications spectrum, reform visa requirements and remove barriers to mining investment
- Spending has been reprioritised to support black commercial farmers, revitalise townships and industrial parks, and rebuild the South African Revenue Service
- Funding has been provided to address urgent matters in health and education, including filling critical medical posts and completing school sanitation projects
- A series of reforms are under way to improve the quality and quantity of public infrastructure projects
- Government is reforming state-owned companies, with Eskom as its immediate focus

Restructuring the electricity sector

- Government's immediate focus is to address the substantial risks that Eskom poses to the economy and the public finances. In its current form, Eskom is not financially sustainable, nor can it meet the country's electricity needs
- Establishing a more competitive electricity sector will improve business and consumer confidence, encourage private investment and reduce upward pressure on prices
- The depth of the financial crisis at Eskom requires government to support the utility's balance sheet, with amounts of R23 billion per year provisionally allocated over the medium term
- The financial support package, with strict conditions attached, will enable Eskom to service its debts and meet redemption requirements, and secure the necessary liquidity to undertake urgent maintenance to restore stable electricity supply
- Further steps in restructuring the electricity market will be announced in the months ahead

Improving infrastructure planning and delivery

Over the next three years, general government infrastructure investment plans amount to R526 billion. Work is under way to improve the quality of this pipeline:

- The Budget Facility for Infrastructure has already strengthened state capacity to consider and budget for large infrastructure projects
- The Development Bank of Southern Africa, the Government Technical Advisory Centre and the Presidential Infrastructure Coordinating Commission receive R625 million for project preparation and implementation
- Local government infrastructure grants are being changed to increase flexibility and incentivise private financing
- Regulation of development charges is being reformed, with the potential to increase local government capital spending by as much as R20 billion per year
- Seven priority programmes worth about R32.6 billion under way in the metros will generate mixed-use, mixed-income living environments, attracting substantial contributions from the private sector over the long term
- Design of a blended-finance infrastructure fund is under way, with government committing a R100 billion to the fund over the coming decade to crowd in private sector, DFI and multilateral funding

Measures to narrow the budget deficit and stabilise the national debt-to-GDP ratio

- **Tax measures amounting to R15 billion in 2019/20 and R10 billion in 2020/21**
  - Gross tax revenue shortfall estimated at R42.8 billion in 2018/19 compared with 2018 Budget, a worsening of R15.4 billion since the 2018 MTBPS
  - Including the proposed tax increases, gross tax revenue shortfalls total R16.3 billion over the next three years, compared with 2018 MTBPS estimates
- **Expenditure reprioritisation**
  - Baseline reductions of R50.3 billion, with about half of this amount relating to compensation
  - These reductions are offset by provisional allocations of R75.3 billion over the next three years, of which:
    - Eskom's reconfiguration (R69 billion)
    - Infrastructure fund (R5 billion) and
    - 2021 Census (R1.3 billion)
- The contingency reserve is increased by R6 billion in 2019/20 (to respond to possible requests for financial support by SOCs), and is lowered by R8 billion in the two outer years of the framework
    - Any financial support agreed on will be raised from the sale of non-core assets and will be excluded from the expenditure ceiling
- The above spending adjustments increase main budget non-interest expenditure by R25 billion over the medium term, compared with 2018 Budget estimates

Tax proposals are expected to generate R15 billion in 2019/20

Impact of tax proposals on 2019/20 revenue[1]

R million		
Gross tax revenue (before tax proposals)		**1 407 208**
Budget 2019/20 proposals		**15 000**
Direct taxes		**13 800**
Taxes on individuals and companies		
Personal income tax	**13 800**	
Revenue from not fully adjusting for inflation	12 800	
Revenue if no adjustment is made	*14 000*	
Partial bracket creep for personal income tax	*-1 200*	
No adiustment to medical tax credit	1 000	
Indirect taxes		**1 200**
General fuel levy adjustment	-500	
Introduction of carbon tax on fuel	1 800	
Additional VAT zero-rated items	-1 100	
Increase in excise duties on tobacco products	400	
Increase in excise duties on alcoholic beverages	600	
Gross tax revenue (after tax proposals)		**1 422 208**

1. Revenue changes are in relation to thresholds that have been fully adjusted for inflation

Adjustments to main budget non-interest expenditure since 2018 Budget

R million	2019/20	2020/21	2021/22	MTEF total
2018 Budget non-interest expenditure	**1 434 907**	**1 543 593**	**1 651 638**	**4 630 138**
2018 MTBPS[1]				
Reprioritisation from slow spending programmes	-8 176	-10 347	-6 798	-25 321
Changes to contingency reserve and provisional allocations not assigned to votes	-1 779	-603	-5 671	-8 052
Reallocations to:				
National and provincial programmes	4 547	4 730	7 189	16 466
Infrastructure: grants, build and maintenance	5 408	6 219	5 280	16 908
Skills development levy adjustment	459	618	706	1 783
2018 MTBPS non-interest expenditure	**1 435 366**	**1 544 211**	**1 652 345**	**4 631 922**
2019 Budget[1]				
Baseline adjustments	-9 002	-19 711	-21 568	-50 281
Changes to contingency reserve	6 000	-2 000	-6 000	-2 000
Additions to spending	24 000	23 000	28 300	75 300
National Revenue Fund payments adjustment	135	–	–	135
2019 Budget non-interest expenditure	**1 456 500**	**1 545 500**	**1 653 077**	**4 655 076**
Change from 2018 Budget[2]	*21 592*	*1 907*	*1 438*	*24 938*

1. Details of baseline adjustments by department provided in the Estimates of National Expenditure
2. Change in non-interest expenditure differs from the change in expenditure ceiling due to the addition of NRF payments, SDL adjustments and the provision for SOC funding in 2019/20
Source: National Treasury

Changes to the expenditure ceiling since 2018 MTBPS

Main budget expenditure ceiling[1]

R million	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
2017 Budget Review	1 074 970	1 144 225	1 229 823	1 323 553	1 435 408		
2017 MTBPS		1 141 978	1 233 722	1 316 553	1 420 408	1 524 222	
2018 Budget Review			1 232 678	1 315 002	1 416 597	1 523 762	
2018 MTBPS			1 225 455	1 314 865	1 416 597	1 523 762	1 630 026
2019 Budget Review				**1 310 156**	**1 430 595**	**1 525 052**	**1 630 758**

1. Non-interest spending financed from the National Revenue Fund, excluding skills development levy, special appropriations in 2015/16 for Eskom and the New Development Bank, debt management and Gold and Foreign Exchange Contingency Reserve Account transactions and the International Oil Pollution Compensation Fund

- The expenditure ceiling also excludes the provision of SOC funding in 2019/20 to be raised from the sale of non-core assets
- After taking account of the various adjustments to non-interest spending, the expenditure ceiling will increase by R14 billion in 2019/20, R1.3 billion in 2020/21 and R732 million in 2021/22 relative to 2018 MTBPS estimates
- In 2018/19, the expenditure ceiling has been maintained, and national and provincial compensation is likely to be lower than budgeted

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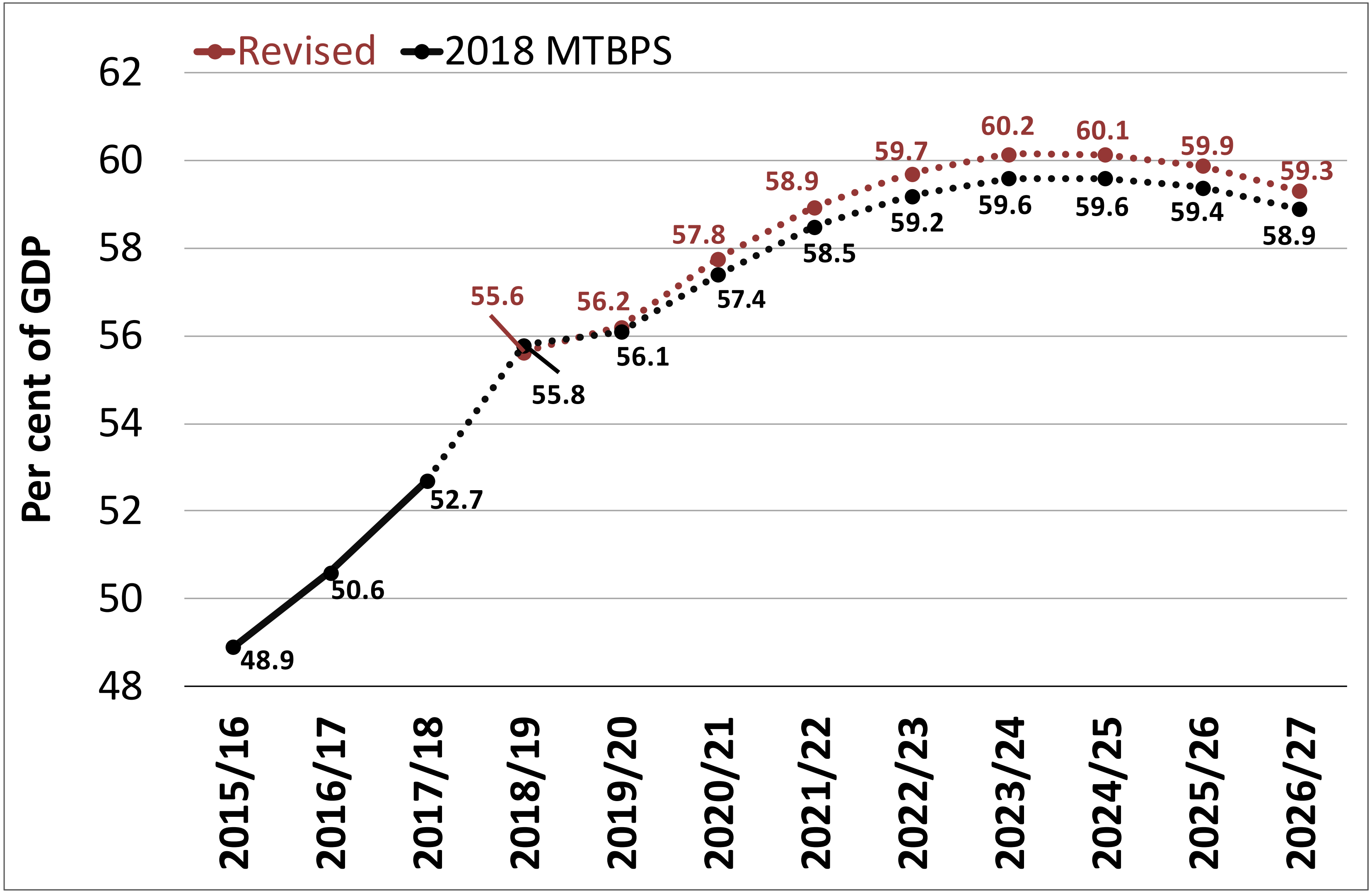
2019 BUDGET

Debt-to-GDP ratio stabilises by 2023/24

Gross debt-to-GDP outlook



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Consolidated fiscal framework

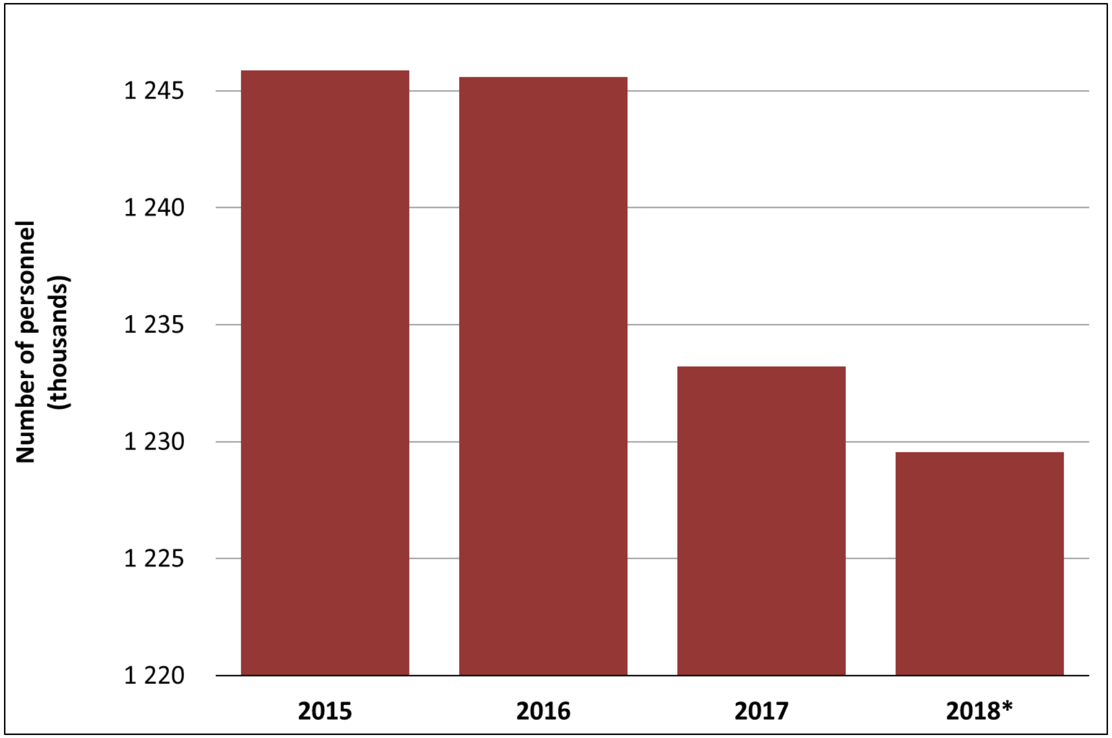
Consolidated fiscal framework

R billion/percentage of GDP	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
		Outcome		Revised estimate		Medium-term estimates	
Revenue	**1 215.3**	**1 285.9**	**1 353.5**	**1 455.2**	**1 583.8**	**1 696.4**	**1 836.6**
	29.4%	*29.1%*	*28.7%*	*28.8%*	*29.3%*	*29.2%*	*29.4%*
Expenditure	**1 366.3**	**1 443.0**	**1 543.8**	**1 665.4**	**1 826.6**	**1 948.9**	**2 089.0**
	33.1%	*32.7%*	*32.7%*	*32.9%*	*33.7%*	*33.5%*	*33.4%*
Non-interest expenditure	*1 227.9*	*1 288.6*	*1 374.0*	*1 476.7*	*1 617.2*	*1 716.2*	*1 833.1*
	29.8%	*29.2%*	*29.1%*	*29.2%*	*29.9%*	*29.5%*	*29.3%*
Budget balance	**-151.0**	**-157.0**	**-190.3**	**-210.2**	**-242.7**	**-252.6**	**-252.4**
	-3.7%	*-3.6%*	*-4.0%*	*-4.2%*	*-4.5%*	*-4.3%*	*-4.0%*

- The consolidated budget includes the main budget framework and spending by provinces, social security funds and public entities financed from their own revenue sources
- Over the MTEF period, consolidated non-interest spending will grow at an annual real average rate of 2 per cent

Managing the public-service wage bill

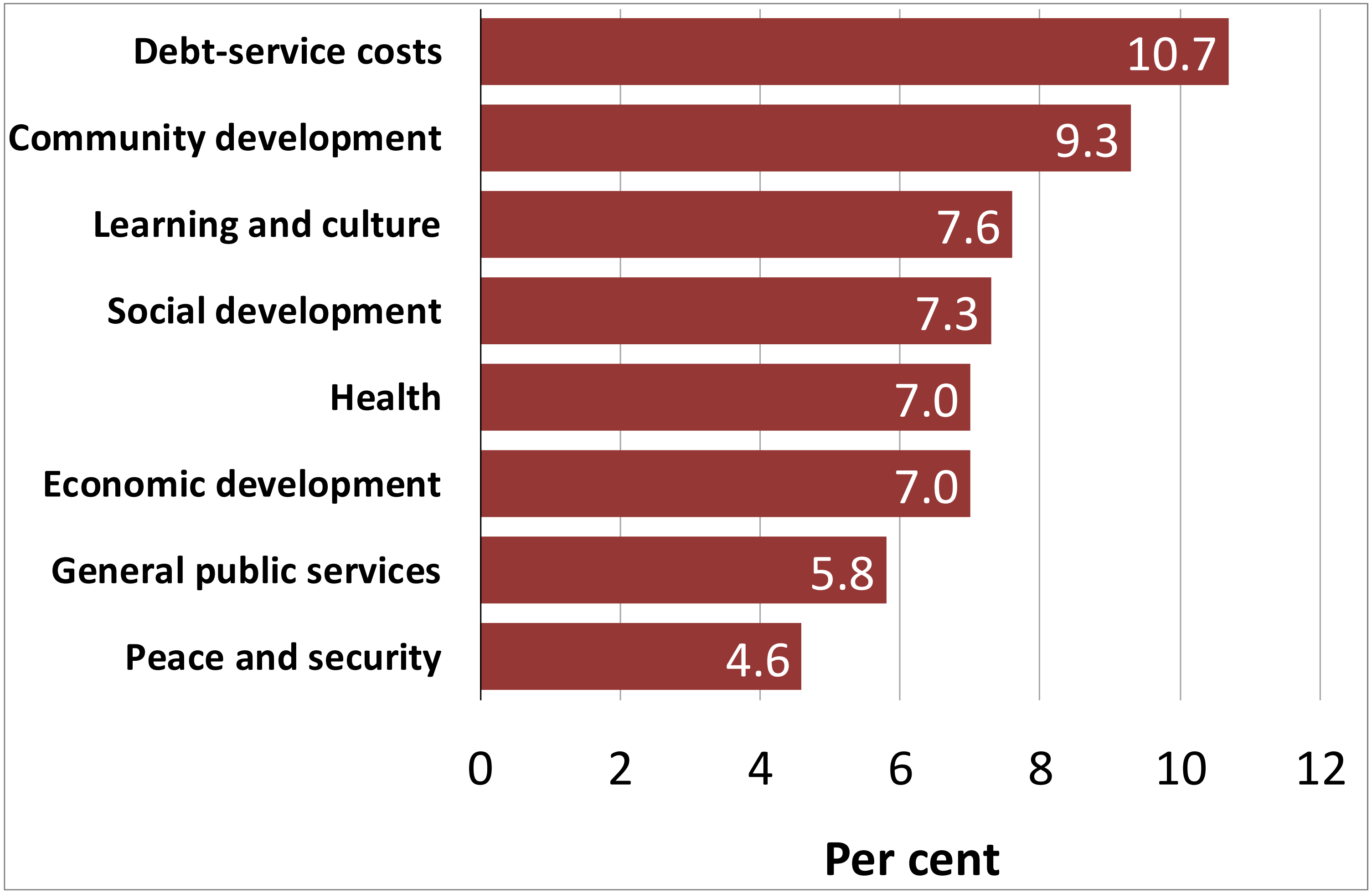
Number of personnel (excluding SANDF)*



- Employee numbers are declining at a rate sufficient to absorb 2018 wage agreement pressures, owing to natural attrition. New employees tend to be younger and lower ranked than employees who are leaving
- Over the medium term, government will take additional steps to manage growth in compensation, including early retirement without penalties
- Proposed reductions to compensation budgets amount to R5.3 billion in 2019/20, R11 billion in 2020/21, and R10.7 billion in 2021/22

Community development is the function with the fastest-growing allocation

Average nominal growth in spending over the MTEF



- Community development includes funding for free basic services and human settlements

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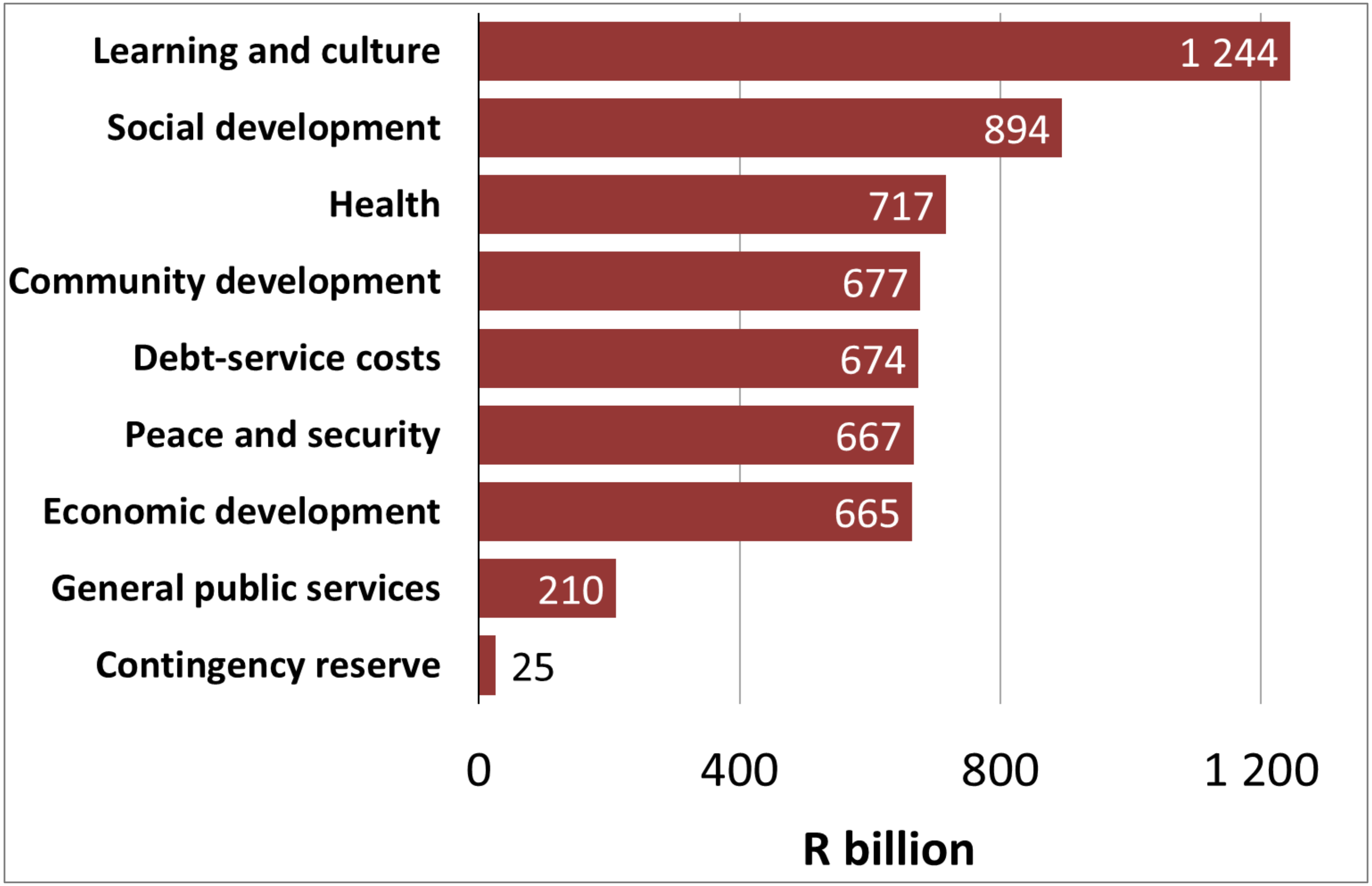
Learning and culture remains the largest function, followed by social development and health

Consolidated government expenditure by function, 2019/20 — 2021/22



Division of revenue

Division of revenue

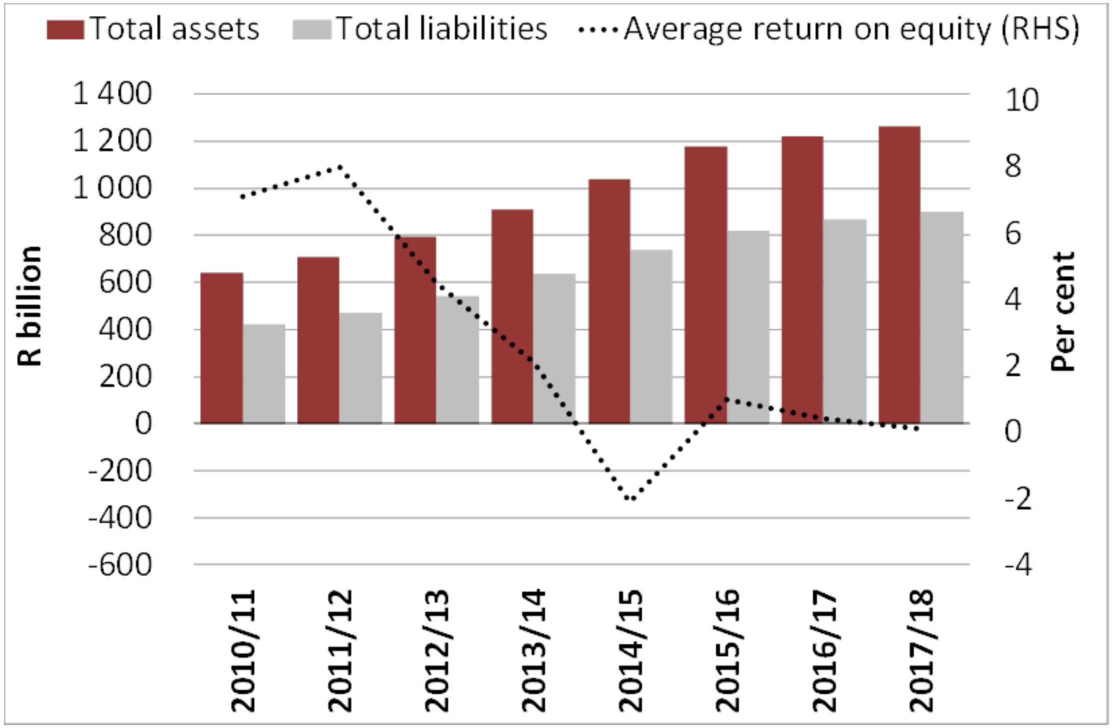
R billion	2018/19	2019/20	2020/21	2021/22
National allocations	638.2	684.7	733.1	777.7
Provincial allocations	572.2	612.3	657.1	701.0
Equitable share	*470.3*	*505.6*	*542.9*	*578.6*
Conditional grants	*101.9*	*106.7*	*114.2*	*122.4*
Local government allocations	117.3	127.3	137.9	149.5
Provisional allocations not assigned to votes	–	19.2	11.4	18.9
Total allocations	**1 327.6**	**1 443.5**	**1 539.5**	**1 647.1**
Percentage shares				
National	*48.1%*	*48.1%*	*48.0%*	*47.8%*
Provincial	*43.1%*	*43.0%*	*43.0%*	*43.1%*
Local government	*8.8%*	*8.9%*	*9.0%*	*9.2%*

Source: National Treasury

- Over the MTEF period, after budgeting for debt-service costs and the contingency reserve, 47.9 per cent of nationally raised funds are allocated to national government, 43 per cent to provinces and 9.1 per cent to local government
- Division of revenue remains strongly redistributive

Financial position of state-owned companies

Financial performance and position of state-owned companies



- Several entities are struggling to meet their debt obligations, with return on equity deteriorating to -0.3 per cent in 2017/18. This reflects weak revenue growth and high cost structures
- Growing debt-service costs from a decade-long debt accumulation phase also weigh heavily on profitability
- Over the year ahead, government will initiate reforms to strengthen the governance, financial management and operations of state-owned companies

Risks to the economic and fiscal outlook

The risks to the fiscal and economic outlook remain elevated:

- State-owned company reform process
- Domestic economic outlook, including load-shedding, higher electricity prices, prolonged industrial action in mining, and adverse weather conditions
- International economic outlook, including slower growth in China, trade frictions, the terms of Brexit, and potential banking sector risks in Europe
- Tax buoyancy and SARS reorganisation process

Conclusion

- The environment remains challenging. The medium-term economic outlook has been revised down, with GDP growth forecast to reach 1.5 per cent in 2019, rising to 2.1 per cent in 2021
- Weak economic performance and residual problems in tax administration have resulted in large revenue shortfalls. The deteriorating financial position of state-owned companies has put additional pressure on the public finances
- The 2019 Budget prioritises narrowing the budget deficit and stabilising the national debt-to-GDP ratio, restructuring the electricity sector and reduce the immediate risks Eskom poses to the economy and the public finances and renewing economic growth and rebuilding state institutions
- The 2019 Budget proposes large-scale expenditure reprioritisation and tax measures that narrow the deficit over the medium term and stabilise gross national debt at 60.2 per cent of GDP in 2023/24
- While progress is being made on various short-term initiatives, South Africa needs to implement a range of structural reforms that will bolster confidence, investment and economic growth
- The state's capacity to implement policy also needs to be strengthened
- Significant risks to economic and fiscal projections remain