Outlook remains stormy, experts say

Although not unexpected, Finance Minister Tito Mboweni's Medium Term Budget Policy Statement (MTBPS) pulled no punches on the cold hard reality of South Africa's economic woes.

Image source: Getty/Gallo

The fiscal outcomes are worse than expected and are due to downward revisions in economic growth, tax revenue collections, more bailout provisions for Eskom, and other state-owned enterprises (SOEs) bailouts while expenditure cuts remain on the margin. The fiscal challenges extend beyond Eskom and will require political will to resolve.

Even after removing the impact of Eskom's bailouts, the debt trajectory still remains unsustainable in the medium and long term, says Isaah Mhlanga, executive chief economist at Alexander Forbes.

What the numbers say

The MTBPS has revised the economic growth forecast to 0.5% in 2019, gradually rising to 1.2%, 1.6% and 1.7% in 2020, 2021 and 2022 respectively. These forecasts are significantly lower than those presented in the February Budget Review, which were 1.5%, 1.7% and 2.1% in 2019, 2020 and 2021 respectively.

The 2019 budget assumed an inflation growth of 5.2% for 2019, and 5.4% for 2020 and 2021. The inflation forecast has been downwardly revised to an average of 4.3%, 4.9% and 4.9% for 2019, 2020 and 2021 respectively, all of which are lower than the budget assumptions. The lower inflation expectations imply that nominal GDP growth will be lower than budgeted.

Sars still under pressure

The budget assumed a tax buoyancy rate of 1.31 in 2019, followed by 1.17 and 1.08 in 2020 and 2021. However, for the past three fiscal years, tax buoyancy has averaged 0.96. Tax buoyancy rates were overestimated, especially in an environment of weak economic growth, high unemployment and declining corporate profitability.

The South African Revenue Service (Sars) warned that there is a high probability that tax collections will disappoint relative to the budget. In line with this, tax buoyancy rates have been reduced to approximately 1.0, Mhlanga says

“Mboweni did mention that we could expect to see more tax increases in the 2020 Budget Speech,” says Maarten Ackerman, chief economist and advisory partner, Citadel.

“However, government is aware that it does not have much room to manoeuvre in this regard, as businesses and consumers are already under severe pressure, and further increases are likely to have a very limited impact in terms of generating additional revenue.

“That leaves government only one other option to increase revenue, namely kickstarting economic growth which would, in turn, increase the size of tax base.”

SOE drag

Eskom and South African Airlines (SAA) were specifically mentioned in the MTBPS. The plan that has been put in place for Eskom needs to be implemented and it should be run as a business was the message from the minister, says Luigi Marinus, portfolio manager at PPS Investments.

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31 Oct 2019

With SAA, Mboweni believes that a structural reform is necessary so that the wealthy and middle-class using SAA services are no longer subsidised by the country, he says.

Cutting expenditure

“What South Africa also needs to turn the fiscal situation around is a strong and sustained improvement in its flagging growth rate, which must remain the overall priority in economic policy. The critical test will be the extent, on the one hand, to which pro-growth reforms needed to turn the economy around are urgently implemented and, on the other, the tough decisions required to break the mould around excessive government expenditure are taken. This will include tackling the vexed question of the role of the public sector wage bill and its disproportionate impact on SA's public finances, sooner rather than later,” says Professor Raymond Parsons, economist at the North West University Business School.

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Downgrade likely

Given the poor outlook, Moody's is likely to change its Baa3 rating of South Africa to negative from stable on 1 November 2019 followed by a downgrade in 2020. Bond yields will likely rise and the rand will weaken against the US dollar; however, both the bond and currency markets appear to have already priced in a potential negative credit rating action. Consequently, should Moody's take negative rating action as we expect and markets sell-off, markets will likely recover over the next 12 months, depending on the speed of implementation of growth-boosting economic reforms. In the absence of these growth-boosting economic reforms, any sell-off in markets will likely constitute a re-rating of South Africa's risk assessment, says Mhlanga.