Economic Focus – A quick take on the Medium-Term Budget Policy Statement 2020

Positive on structural reforms but lingering risk from the execution of the wage bill reduction

Isaah Mhlanga – Chief Economist

Highlights:

- A marginally worse economic environment relative to the June Special Adjustment Budget as economic growth is revised lower.
- Tax revenue underperformance relative to the Special Adjustment Budget's active scenario that's already evident.
- The new tax measures of R25 billion over the medium-term that will be announced in the 2021 Budget Review are unchanged and are likely to fall on higher income earners.
- The proposed fiscal consolidation path that now spreads over five years instead of the previous three years looks realistic. This rests heavily on the downward adjustment in the wage bill which we believe may be politically difficult to achieve especially in the current fiscal year, especially with a pending legal dispute.
- Positive structural reforms will underpin the economic recovery and long-term economic growth potential; however, this is conditional on a successful implementation.

A marginally worse economic environment relative to the June Special Adjustment Budget

The economic environment has marginally worsened since the announcement of the Special Adjustment Budget (SAB) in June 2020 in line with what is observed in other emerging markets but contrary to advanced economies. Recent developments have since shown a pronounced severity of the impact of Covid-19 on the economy as shown by Q2 2020 real GDP which plummeted by 17.1% y/y following the hard lockdown which halted almost all non-essential operations. The National Treasury now expects the real economic growth to contract by 7.8% in 2020 from a previous forecast of 7.2%, with a rebound to 3.3% in 2021 (upwardly revised from 2.6%) before moderating to 1.7% in 2022 and 1.5% in 2023.

However, National Treasury's growth forecast for this year is slightly optimistic than the South African Reserve Bank and the International Monetary Fund projections of -8.2% and -8.0% respectively. Our forecast is for GDP to decline by 10% this year with subsequent growth rates only taking the economy back to 2019 levels at the end of 2024.

Necessarily delayed but implausible fiscal consolidation path

Due to weaker economic growth, tax revenue collections are forecast to be R313 billion lower than projected in the 2020 Budget Review, and R1.6 billion lower than projected in the SAB in June. The results of further shortfalls in revenue and an increase in unavoidable spending, related to protecting lives and livelihoods, has been accommodated by reallocations within the existing budget such that the main and consolidated budget fiscal deficits remain unchanged at 14.6% of GDP in 2020 and 15.7% of GDP in 2021— a huge positive under these circumstances. The debt level rises to 82% of GDP in 2020 from 63.3% in 2019, and it continues to rise and stabilise at 95.3% of GDP in 2025/2026, which is much later than previously projected.

The consolidation path is necessary to reduce the level of debt and ultimately the debt service costs, but it's not plausible on these accounts:

1. It is mostly based on an expected reduction in the government wage bill which is generally difficult in the current political environment.
2. The expected adjustment in the wage bill also assumes that the current year, which is the last year of the wage bill settlement signed in 2018, will be successfully suspended — which is implausible.
3. In addition to the R160 billion in expected wage reductions, a further R75 billion reduction is expected by the end of the 2022/2023 fiscal year, which will require another wage freeze in 2021/2022. We find this highly implausible in the current political environment.

Positive overall messaging on structural reforms to drive the recovery and long-term potential growth

Apart from the risk of failure in implementing the wage bill reductions, the messaging in the MTBPS is positive on the economic reforms proposed, which are in line with National Treasury, the economic recovery as well as the reconstruction announced by the president. The success, however, is conditional on rapid implementation that requires a capable state, which in turn may be derailed by possible protest strikes by public sector employees contesting wage freezes.