

## South Africa Watch

# Spending grip + SARB profits transfer champion short-term boost for Budget

### Fiscal framework unchanged – a short-term positive

With no real new tax measures, the National Treasury largely maintained its call for a grip on spending. It cited nominal reductions in non-interest spending, no new allocations to state-owned enterprises and slower growth in debt service costs, helping to keep fiscal forecasts more constructive than our base case. Non-interest spending is set to grow 4-5% per year, while interest spending should increase by less than 10%.

### Risks to spending could influence fiscal outcomes

There are risks to spending assumptions that could impact fiscal outcomes. Historical wage agreements have resulted in settlements above the Treasury's baseline. Interest spending has grown by 15% over the past three fiscal years. Assuming an increase of less than 10% could be a risk, even if helped by reducing borrowings through central bank profits drawdowns. New spending transfers to Transnet may be delayed rather than denied, as Transnet is too big to fail.

### We turn more positive once Eskom support is phased out

The government expects a main budget deficit of -4.7% of GDP in 2023/24 (BofA -4.8%) and -4.3% for the 2024 budget (BofA -4.5%). Our all-in deficit including Eskom support is above the line at -5.8% in 2023/24E and -5.4% in 2024/25E and -5.6% in 2025/26E. Our forecasts underscore our overall dim view of public finances. To be constructive on the fiscal, we wait for 2026 when Eskom support is phased out, likely resulting in a stronger primary surplus.

### Central bank profits drawdown reduces borrowing

Immediate access to central bank profits (unrealised revaluation gains from central bank FX reserves in the Gold & Foreign Exchange Contingency Reserve Account (GFECRA)) reduces near-term borrowing requirements. The government is set to tap into R150 billion (about 2% of GDP) of GFECRA funds over the next three years. Net borrowings, excluding redemptions, in 2024/25 will likely decline to R385 billion, from R407 billion in 2023/24. However, due to lower GFECRA drawdowns, net borrowings could increase to R418 billion in 2025. As Eskom support is phased out, net borrowings should decline more significantly in 2026 to below R300 billion.

### Leadership continuity at Treasury key post elections

As South Africa heads to elections on May 29, opinion polls suggest governing ANC could fail to win an outright majority and it may need to form a coalition to remain in government. The outcome could be uncertain and noisy. However, the budget presentation looked beyond elections and refuted suggestions of populist spending before voting: no new spending ahead of the election and no tax increases, with the aim to stabilise debt. We hope that, for continuity, the Finance Minister can stay beyond 2024 to continue implementing his fiscal framework. Leadership changes could be a further setback to structurally weak public finances.

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# Post-budget fiscal views

## Short-term boost

The budget provided a short-term boost to the fiscal outlook – the drawdown from central bank profits cut near-term borrowing by R100 billion. However, it will be challenging to reduce fiscal deficits significantly over the next two years. Fiscal consolidation will likely rely on containing expenditure due to few tax options – VAT and PAYE are already at high rates. CIT (corporate income tax) was supposed to trend downwards but will likely stay at the current level as the government can't afford to lose more tax revenues.

New bailout packages for state-owned enterprises were temporarily contained but not eliminated. Transnet is still covered by the R47 billion guarantee and may require future transfers to support its turnaround plans. Like Eskom, Transnet is too big to fail.

Spending increases by R250 billion over the medium term are largely due to budgeting for higher wages and social protection. Budgeting for wages becomes more realistic with average growth of 4.5% compared to close to 2% in the previous framework. Social protection increases suggest the social relief of distress grant could become permanent through increases in overall social protection allocation. For the first time, there is no additional allocations for debt service over the medium term.

## Primary surpluses to anchor fiscal outlook

The National Treasury is targeting consistent primary surpluses over the medium term to anchor fiscal consolidation and debt stabilisation by 2025/26 – an elusive dream over the past 10 years. We think the fiscal outlook is more positive from 2026, when Eskom financing is completed and deficits below 4% of GDP should truly support strong primary surpluses. When we include Eskom allocations in spending, primary balance remains negative until at least 2026.

Increasing tax revenues are likely to rely on higher GDP growth. We see new tax policy measures as limited – there were no increases in the major taxes in the 2024 budget, in line with our expectations. The R15 billion baseline of new tax measures is largely covered by bracket creep – not by adjusting tax brackets for inflation which provides a higher revenue base. The Treasury largely maintained its call for a grip on spending with no new allocations to state-owned enterprises and slower growth in debt service costs helped by tapping into GEFECRA. Additional spending of R58 billion should cover shortfalls in wage bill budgeting.

## Fiscal revenues likely to hold up

Changes to economic growth forecasts to 0.6% in 2023 and 1.3% in 2024 are largely in line with our expectations. Tax revenues are directly affected by changes in nominal GDP growth. Headline revenue projections remain largely unchanged compared to three months ago. While revenue buoyancy in 2024 appears higher than usual (1.33 in 2024/25 vs 0.6% in 2023/24), it reflects the pick-up in economic growth that will be transmitted to revenues. We think revenue targets should be broadly achievable. Tax revenue gains over the medium largely emanate from bracket creep resulting in overall gains of R18.2 billion in 2024/25, R19.3 billion in 2025/26 and R28.2 billion in 2026/27.

## Nominal spending reductions set tone for containment

Expenditure growth is assumed to increase below inflation – in nominal terms, 4% in 2024 and 5% thereafter. The 2023 fiscal year shows control over non-interest spending – down R6 billion from the original 2023 budget guidance. Over the medium term, non-interest expenditure cuts amount to R80.6 billion due to a reduction in the baseline from the February 2023 budget. Nevertheless, some expenditure increases contained in the fiscal framework relate to provisioning for wage increases, social grants inflation related adjustments, , among others. For instance, the Treasury has now factored in additional

allocations for social protection until 2027– amounts similar to those for the social relief of distress grant, implying this funding may become permanent.

## Higher wage increases remain a risk to fiscal outlook

The overall wage bill increase has risen to 4.5% compared to around 2% in the previous framework. Should wage negotiations result in higher increments, the government intends to offset increases within existing budget lines and, if necessary, reduce headcount. Negotiations between the PSA and the public service unions are to begin in the next fiscal year. Higher wage increases present downside risks to the fiscal framework.

Debt service costs have been among the fastest-growing spending items, rising by 15% on average in the last three fiscal years. The pace of growth is assumed to slow to less than 10% pa due to lower borrowing than suggested by headline deficits. This is largely due to drawdowns of central bank profits by the government.

## Deficit and financing

### Exhibit 1: Financing Outlook table for 2024

GFECRA drawdowns of R100 billion reduces borrowings more substantially.

Financing outlook	Revised 23/24	Budget 2024 BofA 2024 baseline	
Main budget balance	-331.38	-321	-341
Redemptions	-145.76	-172.6	-172.6
Eskom debt relief	-78	-64.15	-64.15
GFECRA settlement		100	100
<b>Total financing required</b>	<b>-555.1</b>	<b>-457.7</b>	<b>-477.8</b>
<b>Financing items</b>			
Domestic long term	327.9	328.1	328.1
Domestic short term	88	33	53.1
External borrowing	45.16	36.7	36.7
Use of cash	92.07	59.9	59.9
<b>Total financing</b>	<b>553.13</b>	<b>457.7</b>	<b>477.8</b>

Source: National Treasury, BofA Global Research

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## Domestic borrowing auctions largely unchanged

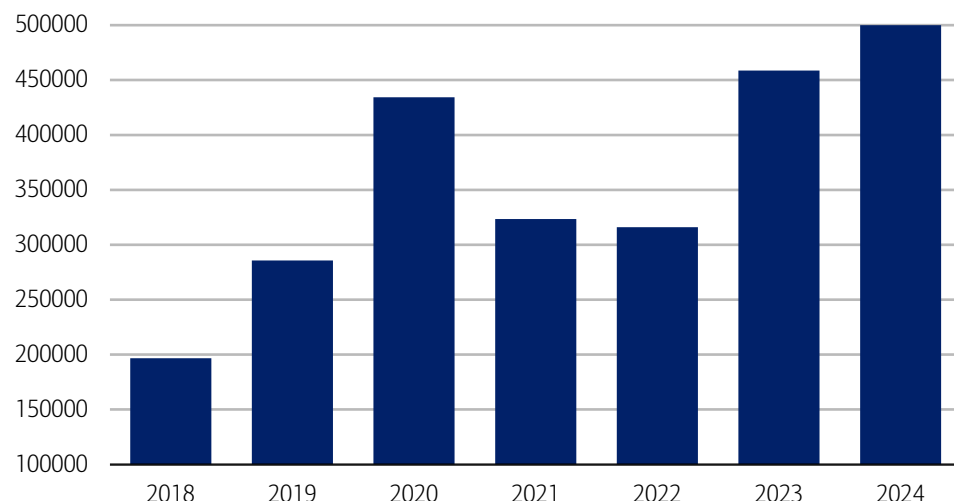
Domestic long-term borrowings were largely left unchanged. Treasury bills were utilised to cover short term funding gaps. Domestic auction changes were made to long term issuances, albeit mildly. The fixed rate bond amounts were reduced marginally to R3.75 billion per week from R3.9 billion, inflation linkers remained unchanged at R1 billion.

## No Eurobond market access near term

Near-term external borrowing remains relatively low. The government expects to borrow \$2 billion in 2024/25 fiscal year largely from concessional sources. There is no baseline for market issuance. External borrowing is likely to be scaled up in 2025 to about \$9.5 billion, with Eurobond market access likely that year.

**Exhibit 2: SARB Gold and FX Contingency Reserve account (Rmil)**

Balance due to SA government have been rising over the years.



Source: National Treasury

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**Lower financing as government taps into GFECRA**

The tailwind for the government is drawing down on the Gold & Foreign Exchange Contingency Reserve Account (GEFECRA). The GEFECRA account has about R500 billion in balances from unrealised gains in the holdings of gold and foreign exchange reserves. GFEFRA is a government account held at the central bank. It records the gains and losses made from FX reserves transactions. As the account is recorded in ZAR while FX reserves are largely in USD, profits tend to show when the ZAR depreciates. R150 billion is to be disbursed as follows: R100 billion in 2024/25 and R25 billion in each of the two subsequent fiscal years.

**Distributing mechanisms of GFEFRA**

The SARB and Treasury have decided not to sell the FX reserves (underlying asset) to finance transfers to the latter. Instead, they will create bank reserves as local currency liabilities on the SARB balance sheet. Government assets, such as deposits on the central bank balance sheet, are a liability for the latter. Other central bank liabilities include excess reserves of banks, which are deposited at SARB and paid interest at the monetary policy rate.

Sterilisation costs are estimated at R8 billion in 2024, R10 billion in 2025 and R12 billion in 2026. Costs are met by the Treasury. Distribution of GFEFRA balances to the National Treasury are not expected to cause inflationary pressures due to the use of liquidity management tools to prevent excess liquidity.

**GFEFRA reform creates three pools**

GFEFRA balances will now be settled instead of remaining unrealised gains. The framework creates three pools: a buffer set at R250 billion; a contingency reserve of R100 billion; and funds for distribution to the National Treasury. The buffer pool is meant to absorb any losses from currency appreciation without resulting in negative balances in the account. The contingency reserve is an additional pool to act as an equity buffer for the SARB, maintained to absorb losses including sterilisation costs when payments are made to the National Treasury. Any remaining funds are then distributed to the National Treasury each year – that is, any amounts above R350 billion.

Mechanisms to protect SARB include: no settlement of GFEFRA balances if it undermines the solvency of the central bank; and no sales of FX reserves to realise GFEFRA gains if FX reserves are below estimated adequacy levels. Any settlements on GFEFRA shall be used to reduce government borrowing and transfers shall be governed

by an agreement and schedule. The transfers are supposed to reduce service costs by R30.2 billion over the medium.

## Medium-term fiscal strategy

- Achieve fiscal sustainability by achieving primary surpluses plus debt stabilisation. The debt-stabilising primary surplus is likely to be around 1% of GDP.
- Support economic growth: energy supply and logistics failures addressed through acceleration of private investment; Eskom's debt-relief arrangement is set to end in 2025/26; and R100 billion of investment in new private energy generation projects. Solar panels are now generating 52000MW of electricity for households and businesses. Transnet received a R47 billion guarantee in 2023/24, conditional on implementation of its comprehensive turnaround plan.
- Reduce fiscal and economic risks by reducing fiscal deficits.

### Exhibit 3: Key Macroeconomic forecasts

Revised economic growth projection downwards to 1.3% from 1.5%.

	2019	2020	2021	2022	2023e	2024f	2025f
Real GDP growth (%yoy)	0.3	-6.0	4.7	1.9	0.5	1.3	1.5
CPI average (%yoy)	4.1	3.3	4.6	6.9	5.9	4.9	4.5
Policy rate (% end of period)	6.5	3.5	3.8	7.0	8.3	7.5	7.0
Fiscal Bal (% of GDP)	-6.1	-9.8	-5.1	-4.6	-5.8	-5.4	-5.6
Primary Bal (% of GDP)	-2.5	-5.7	-0.9	0.0	-0.8	-0.3	-0.3
Debt (% of GDP)	57.2	70.2	68.0	70.9	73.9	76.1	78.1
Current Account Deficit % of GDP	-2.6	1.9	3.7	-0.5	-1.5	-2.5	-2.5
Exchange rate (USD/ZAR end period)	14.0	14.7	15.9	17.0	19.0	17.8	18.4
Exchange rate (USD/ZAR avg)	14.5	16.5	15.0	16.5	18.6	18.2	18.1

Source: Haver, BofA Global Research

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