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FISCAL TRACKER: 2017/18 FISCAL METRICS ARE BETTER THAN INITIALLY EXPECTED

Our monthly fiscal tracker looks at the monthly budget figures adjacent to the historical seasonal trends. We dissect the performances of the revenue and expenditure categories and estimate a budget balance, based on the divergence of the actual performances from the seasonal run rate.

The finalisation of FY17/18 budget data has brought about the closure of what was a tumultuous year from a budget perspective. Total revenues ended the year R3.6 billion higher than the February Budget Review estimates, while expenditures were R7.2 billion below estimates.

The month of March is typically a deficit month – we expected some front-loaded spending by consumers to take place due to the VAT hike coming into effect in April, but this was not the case, or at least did not show up in VAT revenue. Total VAT collection remained more or less in-line with seasonal trends. The upside surprises came from higher custom duties. As a result, the monthly budget deficit was much narrower than our forecast, coming out at R6.5 billion, compared to the R12 billion we had initially forecasted and the R14 billion needed to achieve the Budget Review estimates.

The fiscus ended the 2017/18 year on a relative high; full-year deficit at 4.5% of GDP

The full year main budget deficit was R209.4 billion, or 4.5% of GDP, compared to R217.3 billion, or 4.6% of GDP, forecasted in the February Budget review (Chart 2). Expenditures did most of the heavy-lifting to yield a narrower budget deficit in 2017/18 compared to revenue collection which remained constrained by low confidence, SARS inefficiencies and subdued consumption.

Revenues beat estimates, driven by non-tax revenue

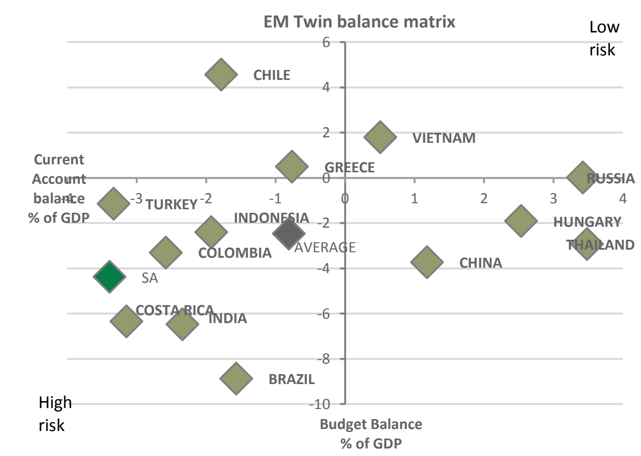
Tax revenue categories disappoint, non-tax revenues provide a final overshoot

Gross tax revenues collected for the full fiscal year amounted to 99.93% of the total budgeted in the February 2018 Budget review compared to 99.97% in the previous fiscal year and the historical average of 100.3%. The disappointment in gross tax revenues was further muted by a smaller decline in unallocated tax revenue (R0.2 billion vs R1.2 billion forecasted).

While gross tax revenues undershot estimates, non-tax revenue items like interest and dividends and National Revenue Fund Receipts exceeded budget estimates. All tax categories disappointed, apart from custom duties. The biggest shortfalls came from withholding tax on dividends and VAT.

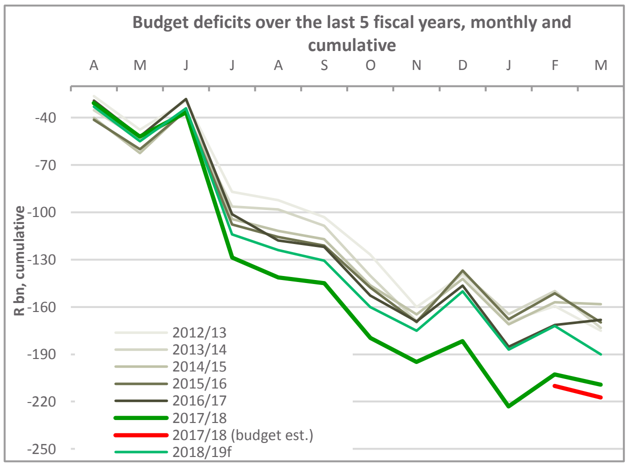
Revenue is expected to recover in the current fiscal year, along with buoyancy rates, mainly due to VAT collection which is projected to add R23 billion as a result of the 1% VAT hike. However, these gains are likely to feature temporarily, unless structural inefficiencies are addressed.

Chart 1: SA twin deficit remains high relative to EM peers



Source: Bloomberg, Nedbank CIB Markets Research

Chart 2: SA budget deficit comes in better than estimates



Source: Nedbank CIB Markets Research, National Treasury, Bloomberg

Expenditure ceiling maintained

Expenditure restraint comes into fruition – can this be carried forward into 2018/19?

Expenditures actually surprised to the downside in the last fiscal year, coming in at R7.2 billion below the budget estimate. This means that expenditures came in at 99.49% of budget estimates, compared to 99.72% in 2016/17.

The biggest cost-savings relative to their own budgets came from the Department of Transport and the Cooperative Governance and Traditional Affairs Ministries. All departments either met or fell short of their budgets, apart from Statistics SA which exceeded its budget by 1%.

While expenditure restraint has come into fruition, our focus is now whether this will be maintained in 2018/19. At the forefront is government wage negotiations that are currently underway, with talks said to be deadlocked and are currently in the conciliation phase with the CCMA. National Treasury seems determined to manage a bloated wage bill which makes up 34% of total expenditure and have enjoyed an average wage increase of 11% over the last 10 years when CPI has averaged 6.1%.

Another expenditure component fraught with uncertainty is the cost of free higher education which was implemented this year. Final registration numbers of students are still outstanding as a result of systems issues between NSFAS and universities, however, the Department appears to have done extensive data collation to approximate the cost of the fee-free higher education policy. It estimates the cost to be approximately R7.2 billion in 2018/19. The actual cost could deviate from this based on final registration, enrolment and qualification numbers.

Tax buoyancy likely to recover to its best level since 2005/06 on the back of the VAT hike, but IMF cautions against complacency

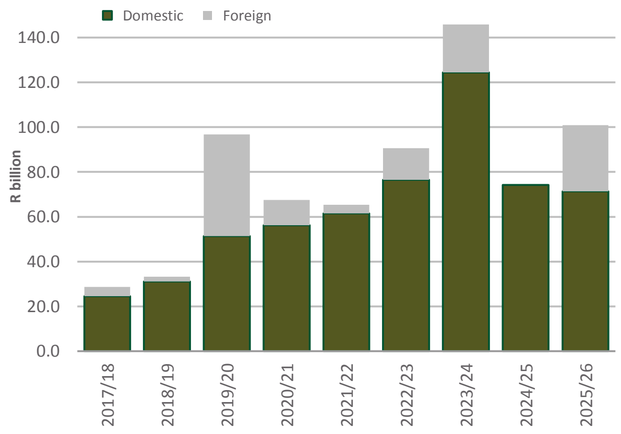
The IMF would like countries to start building capital buffers in preparation for an economic downturn – SA has failed to achieve this in the past

While tax buoyancy is expected to rise (Chart 4), along with nominal growth and economic activity, we believe that one must consider the longer term fiscal trajectory rather than the once-off boost from VAT. Buoyancy levels are expected to normalise close to the long-term average of 1.1 over the medium-term after the 1.51 projected in 2018/19, unless structural reform implementation can raise potential growth.

In its recent World Economic Outlook Update in April, the IMF cautioned both developed and developing countries to not become complacent in the face of the current business cycle upturn and to use this opportunity to start building capital buffers to prepare for the next downturn. While conceding that fiscal policy is generally more constrained by the need to strengthen buffers and ensure sustainability of social insurance programs, the IMF also noted that the strength of short-term economic activity provides an opportunity to start rebuilding fiscal buffers where needed and allows for more policy focus on other medium- and long-term priorities, including structural reform. Whereas SA has failed to do this in the past, it is arguably the opportune time to start preparing for a global economic downturn by cutting inefficient spending, increasing investment and using these proceeds to pay down debt.

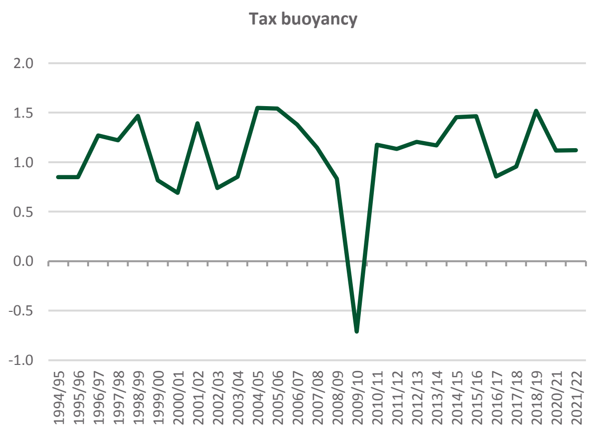
Its research has also shown that fiscal consolidation efforts that focus on cutting current and recurrent expenditures, generally appear to have smaller negative effects on economic activity than an equivalent reduction in public investment (October 2017 Regional Economic Outlook: Sub-Saharan Africa). This implies that the multiplier effect of increased (reduced) investment is far greater than that of increased (reduced) recurrent spending.

Chart 3: Maturity profile of government debt



Source: National Treasury: 2018 Budget Review

Chart 4: Tax buoyancy set to recover in 2018/19 (temporarily)



Source: Bloomberg, Nedbank CIB Markets Research, Bloomberg

Total borrowing was R7.9 billion below estimates in 2017/18

2019/20 is where the pressures lie from an issuance perspective, given R100bn worth of redemptions

As a result of the narrower budget deficit, should nominal GDP meet estimates, this would imply a (main budget) deficit of 4.5% of GDP compared to 4.6% forecasted by National Treasury in the February Budget.

In 2018/19 issuance pressures are more sanguine, with likely more upside risks than downside risks (even lower issuance required). If NT manages to meet or exceed its targets as set out in the February Budget, credit and currency risk metrics may improve, which will likely anchor debt service costs. In 2019/20, close to R100 billion worth of bonds mature, which will need to be rolled over or redeemed, half of which are foreign-currency denominated bonds (Chart 3). Should foreign capital inflows be maintained, bonds yields may remain contained, the rand may remain stable and this may lead to more favourable switch rates/yields in future.

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