2022 Budget preview – revenue boom persists

We project a further upward revision to revenue estimates over the entire MTEF at the upcoming Budget, with the main driver being corporate income tax (CIT) receipts. Our estimates suggest a cumulative R521bn increase in revenue collection from 2021 to 2025 relative to the MTBPS forecast. This is mainly due to the significantly larger base in 2021/22 and our slightly higher GDP growth forecast from 2022 to 2025.

Spending pressures remain, and we, therefore, estimate a cumulative R282bn increase in expenditure relative to the MTBPS forecast over the MTEF. We believe the wage bill, municipal infrastructure backlogs and social relief spending are key spending pressure points over the medium term. The risk to our spending projections is to the upside, in our view.

Despite the upside risk to spending, our optimistic revenue forecast implies a reduction to the Budget's key ratios – we forecast a main budget deficit of 5,4% of GDP in 2021/22 (MTBPS: 6,6%), which declines to 3,9% of GDP by 2024/25 (MTBPS: 4,9%). The debt-to-GDP ratio will likely ease to 74,2% over the same period, in stark contrast to the MTBPS estimate of 77,8%.

This means the 2022/23 financing requirement will likely be R74bn smaller than the November MTBPS estimate. Assuming the National Treasury (NT) maintains its ST loan issuance, foreign loan issuance and cash usage as set out in the MTBPS, and assuming a 25% non-comp take-up in 2022/23, our estimate of the LT loan mix implies no material change to the weekly pace of issuance from current levels.

The table below summarises our key fiscal estimates over the MTEF.

Exhibit 1: 2022 Budget – forecast of key indicators

	2020/21a	2021/22e		2022/23e		2023/24e		2024/25e	
	2021 MTBPS	2021 MTBPS	NCIB	2021 MTBPS	NCIB	2021 MTBPS	NCIB	2021 MTBPS	NCIB
Real GDP growth %	-7,2	6,2	6.1	1,8	2.1	1,6	2.0	1,8	2.0
Nominal GDP growth %	-2,1	10,9	10.8	2,9	6.5	5,5	6.6	6,3	6.5
GDP inflation %	2,9	4,9	4.7	4	4.4	4,4	4.6	4,5	4.5
Nominal GDP (Rbn)	5 566	6 174	6 167	6 351	6 568	6 698	7 002	7 122	7 457
Main budget revenue	1 238	1 483	1 558	1 518	1 651	1 581	1 740	1 689	1 856
Consolidated revenue	1 414	1 649	1 724	1 696	1 826	1 773	1 926	1 891	2 053
Under-/overshoot (Rbn)			75		130		153		162
Revenue-raising measures					5				
Main budget expenditure	1 789	1 893	1 893	1 898	1 962	1937	2045	2039	2148
Consolidated expenditure	1 972	2 129	2 129	2 075	2 139	2126	2235	2240	2349
Under-/overshoot (Rbn)			0		64		109		109
Main budget balance (Rbn)	-551	-410	-335	-380	-306	-355	-305	-350	-292
% of GDP	-9,9%	-6,6%	-5.4%	-6,0%	-4.7%	-5,3%	-4.4%	-4,9%	-3.9%
Primary balance (Rbn)	-318	-141	-66	-77	-3	-21	29	16	74
% of GDP	-5,7%	-2,3%	-1.1%	-1,2%	-0.1%	-0,3%	0.4%	0,2%	1.0%
Consolidated budget balance (Rbn)	-558	-480	-405	-379	-308	-354	-309	-349	-296
% of GDP	-10,0%	-7,8%	-6.6%	-6,0%	-4.7%	-5,3%	-4.4%	-4,9%	-4.0%
Gross debt (Rbn)	3 936	4 314	4 239	4 745	4 773	5 144	5 150	5 538	5 535
% of GDP	70,7%	69,9%	68.7%	74,7%	72.7%	76,8%	73.5%	77,8%	74.2%
Net debt (Rbn)	3 602	4 089	4 014	4 520	4 548	4 935	4 940	5 343	5 340
% of GDP	64,7%	66,2%	65.1%	71,2%	69.2%	73,7%	70.6%	75,0%	71.6%

Source: National Treasury, Nedbank CIB Markets Research

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Tax revenue upside may limit the need for increased debt issuance in 2022/23

As we had shown here, December 2021 was a bumper tax collection month, resulting in the largest December budget surplus on record. Revenue collection was up 88% m/m, and 14,3% of full-year revenue was collected in December 2021 alone (compared to 13% historically). The performance of revenue collection and expenditure usage for the fiscal year to date (fytd to December 2021) are presented in Exhibit 2.

Exhibit 2: 2021/22 pace and growth of revenue collection and spending

		PIT	CIT	VAT	Specific excise duties	Customs duties	Gross tax revenue	Main budget expenditure	Departmental expenditure
A	2021 MTBPS (projected yoy growth)	11%	43%	13%	30%	14%	19%	6%	2%
B	Fytd yoy % chg	15%	74%	19%	70%	16%	30%	4%	4%
C	2021/22 pace	72%	87%	74%	78%	69%	76%	72%	74%
D	2020/21 pace	70%	72%	70%	60%	68%	70%	73%	73%
E	Historical average pace	70%	74%	72%	70%	71%	70%	73%	74%

A = yoy % change as projected in the 2021 MTBPS
B = Current yoy growth rate for the fytd (Apr to Dec 2021)
C = Fytd revenue collection as a % of the full-year target (2021/22)
D = Fytd revenue collection as a % of the full-year total (2020/21)
E = 9y average fytd collection (or spending) as a % of the full-year total

Source: Nedbank CIB Markets Research, National Treasury

Gross tax revenue growth is tracking at 30% yoy, which would imply a buoyancy rate of 2,80 compared to the 1,73 projected in the November MTBPS. While we expect tax revenue buoyancy to ease slightly in the last three months of the current fiscal year, our estimate of the full-year buoyancy of 2,30 is still well above the NT's last estimates. This, therefore, implies a potential revenue overshoot of R75bn over MTBPS estimates for 2021/22.

Simply using our own nominal GDP forecast over the rest of the MTEF (which is, on average, 163 bps higher than the MTBPS forecast) with this higher revenue base from 2021/22 results in a cumulative revenue overshoot from 2021 to 2025 of R521bn.

Our estimates suggest no pressing need to raise the pace of debt accumulation in 2022/23, especially due to the lower financing requirement (smaller budget deficit) relative to earlier forecasts.

Projected financing strategy for 2022/23

Our estimate for the main budget deficit for 2022/23 is R306bn, or 4,7% of GDP, compared to R380bn (6% of GDP) in the MTBPS. This means the financing requirement will likely be R74bn smaller than the November MTBPS estimate.

Assuming the NT maintains its ST loan issuance, foreign loan issuance and cash usage as set out in the MTBPS, and assuming a 25% non-comp take-up in 2022/23, our estimate of the LT loan mix implies no material change to the weekly pace of issuance from current levels.

Exhibit 3: The government's financing strategy

Rbn	2021/22f				2022/23e		
	2021 MTBPS	Current	NCIB		2021 MTBPS	NCIB	
Nominal bonds:	**245,4**	**265.3**	**179.2**	Weekly issuance (current)	**328,3**	**264.5**	Weekly issuance required in 2022/23
Issuance for the year	164,4	206.1	127.2	3.9	220,0	198.3	4.1
Total non-comps	81,0	59.2	52.0		108,4	66.1	
ILBs:	**39,9**	**54.3**	**29.2**	1.2	**53,5**	**43.1**	0.9
Total long-term market loans	**285,3**	**319.6**	**208.4**		**381,8**	**307.5**	
Short-term loans and T-bills	0,0	**0.0**	**0.0**	11.7	54,0	**54.0**	
Foreign loans	77,6	**77.6**	**77.6**		47,0	**47.0**	
Cash	112,2	**112.2**	**112.2**		10,5	**10.5**	
TOTAL FINANCING REQUIREMENT	**475,1**	**509.4**	**398.2**		**493,4**	**419.0**	
(Less) redemptions	-65,2	**-65.2**	**-65.2**		**-113,0**	**-113.0**	
Main budget deficit	**409,9**	**444.2**	**333.0**		**380,4**	**306.0**	

Current = Current pace of debt issuance will be able to fund this deficit, NCIB estimate; NCIB = Projected deficit and required debt issuance
Source: National Treasury, Nedbank CIB Markets Research

Importantly, the main budget deficit for the current year will likely be revised smaller as well, with our estimate at R333bn, or 5,4% of GDP, compared to R410bn (6,6% of GDP) in the MTBPS. We estimate there will be R112bn of excess debt issuance in the current year, which will likely be used to prop up the NT's cash buffer, after cash usage of R110bn in January 2022.

Funding strategy changes ahead

We believe there will be a few changes to the issuance strategy over the near and medium term:

- **Floating-rate note (FRN) issuance:** The NT has been mulling issuing a short-dated FRN for some time now, but has explicitly excluded it from its financing strategy to date. The last FRN was issued in 2005 (matured in 2012), with R7,8bn issued, and with the coupons linked to the 3m T-bill rate. The NT omitted to mention the new floater in its financing strategy again at the last MTBPS, but subsequently confirmed that this will be implemented before the end of March 2022. No further details were provided by officials on the floater, but we believe it may go ahead in 2022/23 with a short-dated tenor (<5y) in a relatively small size (<R12bn), given the NT's historical preference.
- **Sukuk issuance:** In its February 2021 Budget Review, the NT stated that "the National Treasury will issue a domestic rand-denominated Islamic Sukuk bond in 2021/22 to diversify funding sources and reach new investors". In 2014, the NT issued a USD500m, 5,75y Sukuk bond to international investors, and the auction was oversubscribed and highly successful. A Sukuk bond issuance was omitted from the financing strategy in the 2021 MTBPS, but in the Q&A session, NT officials mentioned that a Sukuk issuance will take place before the end of March 2022. No further details were provided on the expected Sukuk issuance. At this stage, this may be deferred to 2022/23, in our view.
- **Issuance maturity:** We expect the financing mix to maintain 77% of LT debt issuance in the 3-16y maturity area in order to lower debt-servicing costs. Before the MTBPS, the average maturity of weekly nominal fixed-rate bond issuance was 15.4 years. After the MTBPS, this dropped to 14.3 years (after lengthening from 13.7 years in 2020/21).

Key drivers of excess revenue collection

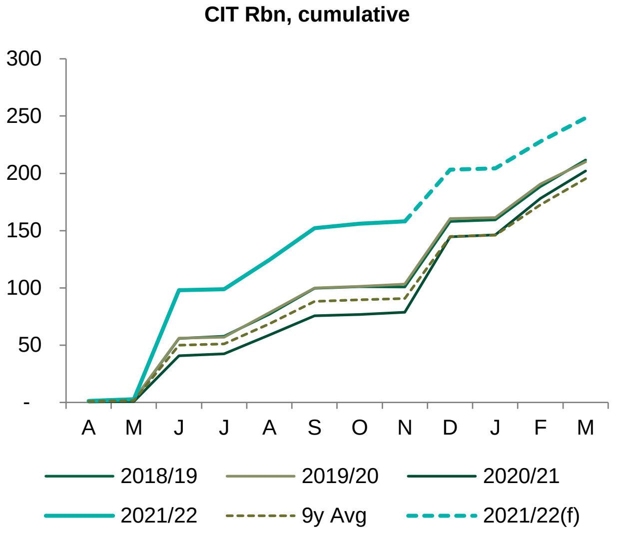
Our analysis suggests CIT revenue collection will be the key upside driver of revenue collection in 2021/22. The significantly higher base from 2021/22 implies continued outperformance of CIT collection in 2022/23, in our view.

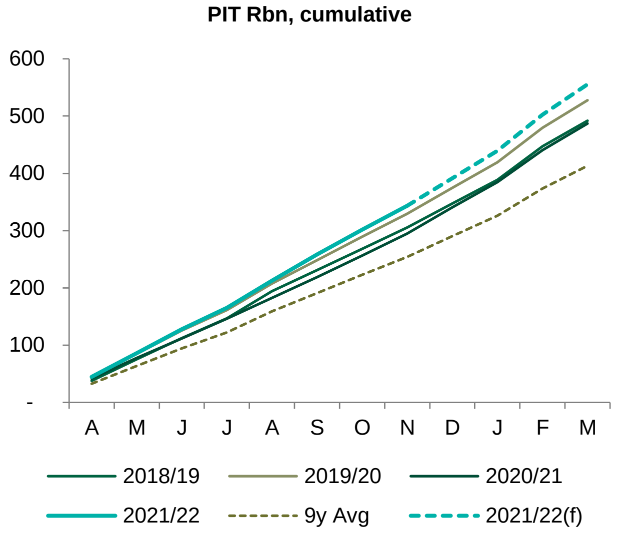
Exhibit 4: Summary of estimates – revenue

	2020/21a	2021/22e		2022/23e		2023/24e		2024/25e	
	2021 MTBPS	2021 MTBPS	NCIB	2021 MTBPS	NCIB	2021 MTBPS	NCIB	2021 MTBPS	
Tax revenue buoyancy	3.71	1.73	2.30	0.98	0.99	0.96	0.97	1.06	1.00
Rbn									
Main budget revenue	1238	1483	1558	1518	1651	1581	1740	1689	1856
Under-/overshoot (Rbn)			75		133		159		166
Consolidated revenue	1414	1649	1724	1696	1826	1773	1926	1891	2053
Personal income tax	487	542	555	579	579	618	618	666	670
Corporate income tax	202	289	345	228	380	220	400	231	420
Value-added tax	331	374	379	428	450	461	461	491	500
Gross tax revenue	1250	1485	1560	1527	1661	1608	1767	1715	1882
% yoy									
Main budget revenue	-8.0	19.8	25.8	2.3	5.9	4.2	5.4	6.8	6.6
Consolidated revenue	-6.9	16.6	21.9	2.8	6.0	4.5	5.5	6.7	6.6
Personal income tax	-7.7	11.3	13.9	6.8	4.3	6.8	6.8	7.7	8.4
Corporate income tax	-4.4	42.8	70.9	-20.9	10.0	-3.5	5.3	4.7	5.0
Value-added tax	-4.5	12.9	14.5	14.3	18.6	7.8	2.4	6.5	8.5
Gross tax revenue	-7.8	18.8	24.8	2.8	6.4	5.3	6.4	6.7	6.5

Source: National Treasury, Nedbank CIB Markets Research

Exhibit 5: Projected full-year collection of corporate and personal income taxes





Source: Source: National Treasury, Nedbank CIB Markets Research

Corporate income tax collection: key drivers

We believe CIT revenue collection will be revised R58bn higher for 2021/22 relative to the MTBPS due to the following reasons:

- **Mining output**: The MTBPS noted that higher export prices have boosted the profitability of SA's mining and manufacturing industries, while also facilitating a recovery in auxiliary services such as finance and business services. According to data from Stats SA, the value of mineral sales (at current prices) for the fytd was up 45,2% yoy in November 2021 (latest available data). SARS has noted a 31% yoy surge in exports in 2021, while SA's trade surplus was 62% larger than the 2020 surplus. The customs value for SA's top 10 commodity exports was 40% higher than the value in 2020. SA's terms of trade remain favourable, and close to their 2011 high, which would have supported profitability and tax collection from the mining industry in 2021/22. The high base carries through into 2022/23, despite the annualised growth in CIT collection falling markedly (Exhibit 4) and then normalising from 2023/24. The upside from this year will be baked into the base, in our view.
- **Manufacturing output:** The value of SA's manufacturing sales (at current prices) had risen 21% yoy for the fytd to November 2021 (latest available data). SA's manufacturers also benefited from SA's export boom, with the MTBPS noting a 119% rise in tax receipts from the manufacturing industry during the first six months of the fiscal year (compared to the same period in 2020/21). PMI data since November suggests a continued recovery in the manufacturing industry, which would support tax revenue.
- **Financial and business services:** SA's primary and secondary sector businesses drive output in the financial and business services sector. Data presented in the MTBPS showed a 37% yoy increase in CIT receipts from the financial services industry during the first half of the current fiscal year. Economic activity data since September 2021 shows a continued rise in freight and passenger transportation income, while the number of liquidations fell to a two-year low in 2021, suggesting improved business prospects recently. Higher interest rates since November will also buoy bank profitability in 2021/22 and over the MTEF. This will be supportive of tax collection in both 2021/22 and 2022/23, in our view.

Our analysis points to a further R12,5bn upward revision to PIT collection, and a R5,7bn rise in VAT collection relative to MTBPS forecasts. For 2022/23, given the continued recovery in domestic demand, we believe this will drive VAT collection sharply higher, with growth of 18,6% yoy expected, compared to the MTBPS forecast of 14,3%. Importantly, we think the risk to our revenue estimates is to the upside.

Revenue-raising measures

We believe revenue-raising measures will be limited, given elevated levels of joblessness and expectations for growth to settle close to potential over the medium term.

- Above-inflation increases in specific excise duties on alcohol and tobacco expected to raise about R2,5bn.
- Given the surge in local fuel costs as a result of higher oil prices recently, and given the increased scrutiny on the composition of the basic fuel price, we believe the increase to the fuel levy will be marginal (12c/litre), contributing about R2,8bn towards government revenue in 2022/23.

Expenditure pressures over the MTEF

Spending remains a key uncertainty over the MTEF. Aspects such as the introduction of a basic income grant (BIG) have drawn input from politicians and civil society, which if not announced in the 2022 Budget, will be finalised in the coming months, in our view.

We have revised our spending estimates up by a cumulative R282bn from 2022 to 2025 with the following components potentially presenting upside pressure, in our view:

- SOE bailouts – an additional R12bn is added to the 2022/23 expenditure estimate for SASRIA/other SOEs
- Wage bill – an additional R52bn is added to spending on the wage bill from 2022 to 2025
- Social relief/BIG – an additional R117bn is added to spending from 2022 to 2025 to account for the possibility of a new grant being implemented
- Local government – an additional R100bn is added to local government budgets in order to address infrastructure backlogs over the MTEF

Municipal infrastructure backlog

An area that may come up for discussion in the draft Macro Economic Policy Review document that is due for release in March is the infrastructure backlog specifically at the municipal level. This backlog is not only a hindrance to service delivery but also a drag on growth, especially in rural areas. We believe the cost of addressing this infrastructure backlog at municipalities could be in the order of 5% of GDP, with various municipal functions such as roads, water, sanitation and storm water needing repair, improvements and expansion. Although this has not been flagged as a growth policy, municipalities could require additional outlay from the government of about R45bn per year over a 10-year period to ensure the proper functioning of local government.

Wage bill uncertainty

The 2018 wage bill agreement is currently being contested in the Constitutional Court. If unions are successful, this could result in the court granting public servants back-pay for the third year of the 2018 wage agreement, which was cancelled by the NT, with costs amounting to as much as R40bn. Last year, the one-year wage agreement settled with unions granted public-sector workers an effective 6% salary increase and resulted in a R15bn overshoot in spending. The new round of wage discussions has not begun, despite just two months left until the end of the current wage agreement. While the NT had raised the wage bill for 2022/23 by R9bn at the time of the MTBPS, we believe an eventual agreement could place further upward pressure due to higher inflation estimates, and given precedence. We have, therefore, raised compensation spending over the next three years by R12bn, R20bn and R20bn, respectively.

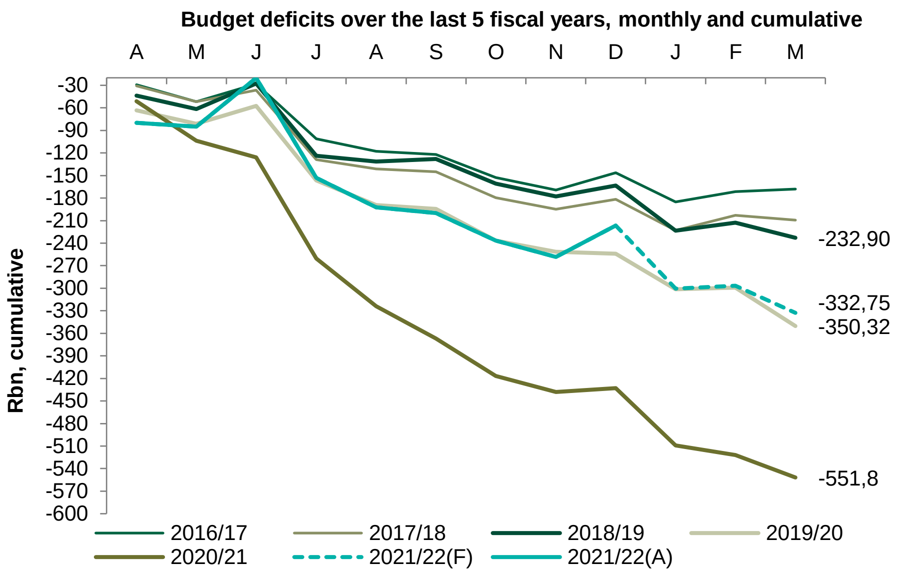
Additional social spending initiatives

The government is currently deliberating on whether to implement a basic income grant (BIG) or extend the Social Relief of Distress (SRD) grant temporarily. We believe the SRD may be extended for a further 12 months, at a cost of R42bn p.a., after which a BIG may be implemented at a cost of more than R70bn p.a. It is worth noting that the NT has provisioned for unallocated reserves of R15,1bn, R28,8bn and R29,3bn over the next three years, respectively, which we believe may be used to partly fund this additional social spending. We have, therefore, raised our spending estimates by a cumulative R117bn over the MTEF to account for the possible implementation of this new grant.

The Budget's bottom lines

The annual budget balance appears to have retraced to its pre-pandemic trend and level in 2021/22 (Exhibit 6). We project a deficit of R333bn (5,4% of GDP), compared to R410bn (6,6% of GDP) estimated in the MTBPS. The risk for 2021/22 is to the upside, ie that the deficit may be even smaller than our estimates given upbeat revenue collection during the last three months of the fiscal year.

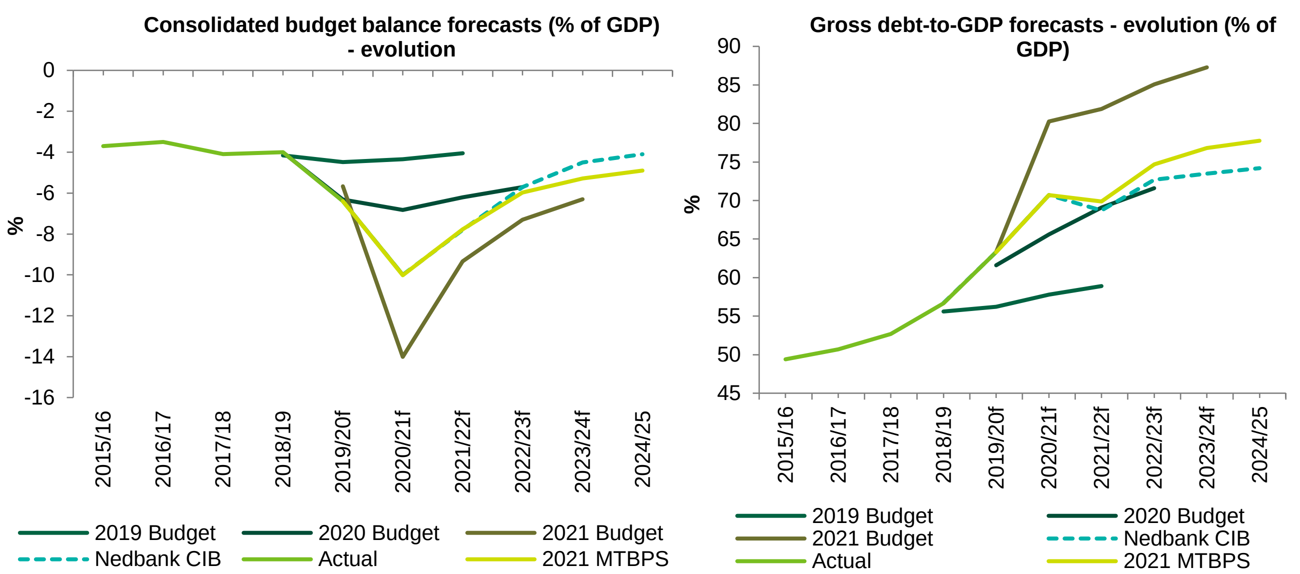
Exhibit 6: Projected deficit returns to pre-pandemic trend



Source: National Treasury, Nedbank CIB Markets Research

The MTBPS noted that debt-servicing costs are estimated at R1tr over the MTEF, exceed all individual spending items by functions (apart from learning and culture) and are the fastest-growing expenditure component of the budget. While we project a marginally lower debt-to-GDP ratio relative to the MTBPS, debt-servicing costs are expected to remain elevated over the MTEF, rising towards 20% of revenue by 2024/25.

Exhibit 7: Deficit and debt compression expected as a result of revenue boom in 2021



Source: National Treasury, Nedbank CIB Markets Research

- Our baseline fiscal forecasts show the main budget deficit narrowing to 3,9% of GDP by 2024/25 (from 9,9% in 2020/21). This compares favourably to the MTBPS estimate of -4,9% of GDP and our previous estimate of 4,0%.

- A debt-to-GDP ratio of 68,7% can be achieved in the current year (down from our previous estimate of 70%) – we believe the ratio will now peak in 2024/25 at 74,2% (prev. 75,1%) before consolidating in the outer years. This is in stark contrast to the 2021 MTBPS forecast of a peak of 77,8% in 2024/25. Importantly, the risk to this forecast is to the upside, given uncertain expenditure pressure that might present itself over the MTEF.
- Expenditure remains highly uncertain and, therefore, the hurdle rate to achieving a primary surplus remains high. Nonetheless, our baseline forecast projects a primary balance surplus by 2023/24.

Exhibit 8: Summary of our core macroeconomic and market views

Growth	We expect GDP growth of 5,0% yoy in 2021 and 2,0% yoy in 2022.
Currency	Our neutral range for the USDZAR is between 15,10 and 15,70, with a year-end target at 16,00. As such, we remain better buyers of USD when the rand strengthens to far below this range.
Inflation	We believe inflation will likely remain muted for some time. However, we expect inflation to rise sharply in the near term, due to higher administered prices, before settling back to SARB's midpoint target of 4,5%. We forecast CPI (average) at 4,5% in 2022 and 5,0% in 2023.
SARB	We expect SARB to hike by 25 bps in March. We forecast 75 bps worth of hikes in 2022, but we have a repo rate ending 2023 at 5,00%, compared to SARB's 6,12%.
Bond yields	Global factors, including a tighter monetary policy stance, higher global inflation rates and a higher risk-free rate (UST yields) have raised fair-value yields since our last update. Our fair-value estimate for the 10-year yield is 9,9% (R2032). We adjust our fair-value range for the R2048 50 bps higher to 10,50-11,00%.
Rating action	The recent GDP rebasing positively affected the sovereign's near-term debt burden metrics, and the revenue overshoot has helped narrow the primary budget deficit compared to what was expected earlier in the year. However, what induced the last cycle of downgrades was the pace at which debt was accumulating, rather than the absolute stock level of debt. While the pace of accumulation should slow in the coming years, rating agencies remain cautious, as long-run risks to GDP growth and fiscal stability still weigh on the credit outlook. The agencies still worry about commodity price reversals, the impact of global rate increases on emerging-market risk sentiment and the impact of local socio-political pressures on expenditure ceilings. Eskom and other SOE bailouts continue to cloud the fiscal outlook, while reforms are only taking shape slowly. Fitch rates South Africa "BB-/Stable", Moody's "Ba2/Neg." and S&P "BB-/Stable".

Source: Nedbank CIB Markets Research

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