strategy&
*Part of the PwC network*

# South Africa Economic Outlook

## Fiscal perspectives ahead of the Medium Term Budget Policy Statement (MTBPS)

26 October 2023

pwc

> *Government spending makes only a small direct contribution to overall economic growth. However, public sector expenditure is at the core of economic development and socio-economic upliftment. In addition, public services provide the basic hard and soft infrastructure needed by the private sector to grow their business and employment. These are key reasons why an expected shortfall in fiscal revenue during 2023/2024 is bad news for the South African economy. The Medium Term Budget Policy Statement (MTBPS) 2023 will provide answers as to how the National Treasury plans to address this challenge.*

**Lullu Krugel,** PwC South Africa Chief Economist

# About this document

This edition of the South Africa Economic Outlook focuses on key economic and fiscal factors ahead of the Medium Term Budget Policy Statement (MTBPS), set to be released on 1 November.

South Africa's fiscal environment has deteriorated since the publication of Budget 2023 (in February this year), with the last several months seeing increased concern over the expected shortfall in government revenues during 2023/2024 alongside a deteriorated macroeconomic situation. Pressures on household spending, business investment, export revenues, and the cost of imports have all resulted in weaker-than-expected tax income.

We have crunched the numbers and determined that the total tax revenue shortfall could reach R30bn in the 2023/2024 fiscal year. This would be a significant improvement over an earlier prognosis — around R50bn — following strong collections of Corporate Income Tax (CIT) during August. Nonetheless, MTBPS 2023 will have to make a plan to address this gap, and also speak to the more conservative outlook for revenues over the medium term.

Key contents of this report include:

- Global context: Many African countries experienced increased fiscal pressures over the past six months (page 4).
- Local macroeconomic trends: The changing economic outlook from Budget 2023 to MTBPS 2023 (page 5).
- Fiscal revenue shortfall: Likely smaller than initially expected after improved corporate tax collections in August (page 7).
- Narrowing the funding gap: Banking on improved tax compliance to improve the medium-term fiscal outlook (page 8).

Lastly, in the context of constrained fiscal revenues, we comment on a new public-private collaboration model (which PwC helped develop and implement) that allows South African businesses to support the delivery of key public services to their communities (page 9).

*Note that on 1 November, PwC will issue a post-MTBPS comment reflecting on some our predictions in this report and what the policy statement revealed in this regard.*

**Macroeconomic forecasts (October 2023)**

| Baseline scenario | 2021 | 2022 | 2023f | 2024f |
|---|---|---|---|---|
| ZAR/USD | 14.78 | 16.37 | 18.55 | 19.05 |
| Consumer price inflation (%) | 4.6 | 6.9 | 6.0 | 5.2 |
| Repo rate (end-of-period) | 3.75 | 7.00 | 8.50 | 7.75 |
| Real GDP growth (%) | 4.7 | 1.9 | 0.5 | 1.1 |
| Unemployment rate (%) | 35.3 | 32.7 | 33.5 | 33.9 |
| **Probability weighted average** | **2021** | **2022** | **2023f** | **2024f** |
| ZAR/USD | 14.78 | 16.37 | 18.58 | 19.24 |
| Consumer price inflation (%) | 4.6 | 6.9 | 6.0 | 5.3 |
| Repo rate (end-of-period) | 3.75 | 7.00 | 8.46 | 7.76 |
| Real GDP growth (%) | 4.7 | 1.9 | 0.4 | 0.9 |
| Unemployment rate (%) | 35.3 | 32.7 | 33.5 | 34.0 |

# Global context: Many African countries experienced increased fiscal pressures over the past six months.





**Fiscal revenues are under pressure in many countries due to a combination of factors, including the long-term effects of COVID-19 on employment, disruption in the flow of commodities across markets, tighter monetary policy, and extreme weather events. Due to the resultant lower tax income, governments need to borrow more. This, in turn, is pressured by high interest rates, risk aversion increasing the cost of debt, and currency depreciation.**

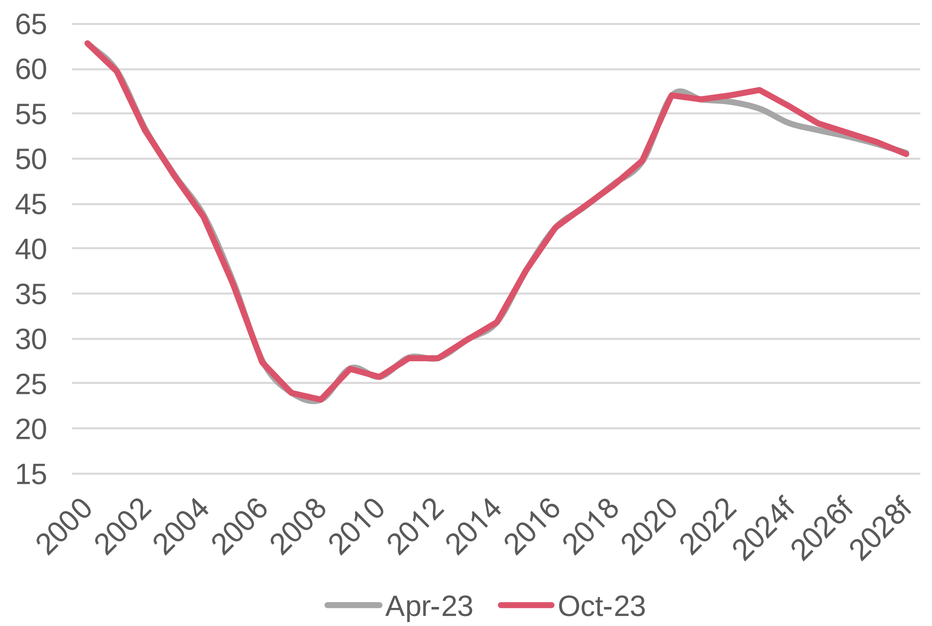
## African government debt ratios will be higher this year than the IMF previously expected.

The International Monetary Fund (IMF) World Economic Outlook (WEO) October 2023 report warns that the global recovery from COVID-19 and the ongoing conflict in Ukraine "remains slow and uneven". It adds that, "[d]espite economic resilience earlier this year, with a reopening rebound and progress in reducing inflation from last year's peaks, it is too soon to take comfort". Regarding the state of public finances, the IMF notes that "fiscal buffers have eroded in many countries, with elevated debt levels, rising funding costs, slowing [economic] growth, and an increasing mismatch between the growing demands on the state and available fiscal resources." It warns that this "leaves many countries more vulnerable to crises and demands a renewed focus on managing fiscal risks".

For a perspective on the change in fiscal conditions, we considered the IMF's forecast for government debt, and how this has changed over the past six months. From the IMF World Economic Outlook (WEO) database, we look at the trend in general government gross debt as a percentage of GDP across African countries. The ratio takes into account important aspects to the fiscal equation, namely: the balance of government revenues and spending — a deficit requiring borrowing — and the size of the economy. (See page 5 for our comments on South Africa's economic situation and page 7 for comments on fiscal revenue and expenditure factors.)

The IMF's forecast for Africa's general government gross debt in 2023 increased from 55.5% of GDP in April to 57.7% of GDP in October. This will be the highest reading in more than two decades. There are, of course, some base effects involved in this difference, due to upward adjustments that the IMF recently made to its 2022 data. Nonetheless, the IMF now sees government debt in African countries increasing by 0.6 percentage points during 2023 after forecasting in April that it would decline by 0.7 percentage points. For some, these numbers might seem marginal. However, at a time when global leaders are very concerned about the recent increase in public debt ratios across most of the world, any further upward adjustment in forecasts for Africa is a point of concern. With this upward adjustment the IMF is essentially saying that, on aggregate, the imbalance between fiscal revenues and expenditure, alongside other economic and financial factors, will result in larger borrowing requirements this year than previously thought.

*Figure 1: Africa general government gross debt (% of GDP)*




*Source: IMF*

## Increased social protection spending needed after 165m people globally fell into poverty during 2020-2023.

The IMF WEO October 2023 report provides detail on some of the key challenges currently impacting the global economy and, inter alia, the ability to grow business activity and fiscal revenues:

- Long-term consequences of COVID-19 on the labour market.
- Increasing geoeconomic fragmentation constraining the flow of commodities across markets.
- Monetary policy tightening to combat elevated consumer price inflation.
- Extreme weather events as the global average temperature hit a record high in July 2023.

From a fiscal expenditure perspective, the combined negative forces of high consumer price inflation and (in some countries) employment levels still below the pre-pandemic level have necessitated increased social protection spending by governments. According to the United Nations Development Programme (UNDP), an additional 165m people globally fell into poverty (living on less than $3.65-a-day) during 2020-2023.

Where fiscal spending is larger than revenues, governments need to borrow. This, too, has become more challenging (expensive) in recent quarters due to several reasons:

- Upward adjustments to interest rates by a majority of central banks.
- Higher risk aversion increasing the cost of sovereign borrowing.
- Currency depreciation inflates the cost of servicing debt denominated in offshore currencies.

Overall, the global macro environment has been less accommodating towards fiscal finances over the past six months, resulting in increased public sector borrowing needs.

# Local macroeconomic trends: The changing economic outlook from Budget 2023 to MTBPS 2023.



South Africa Economic Outlook October 2023

**Macroeconomic forecasts have deteriorated since the release of Budget 2023: inflation is taking longer to decline, interest rates have increased by more than expected, and GDP growth is slower than initially projected. Lower growth is linked to the weak outlook for household finances which is pressuring consumption spending as well as negative business confidence impacting on capital formation.**

## Consumer price inflation has been slow to decline and interest rates have increased by more than expected.

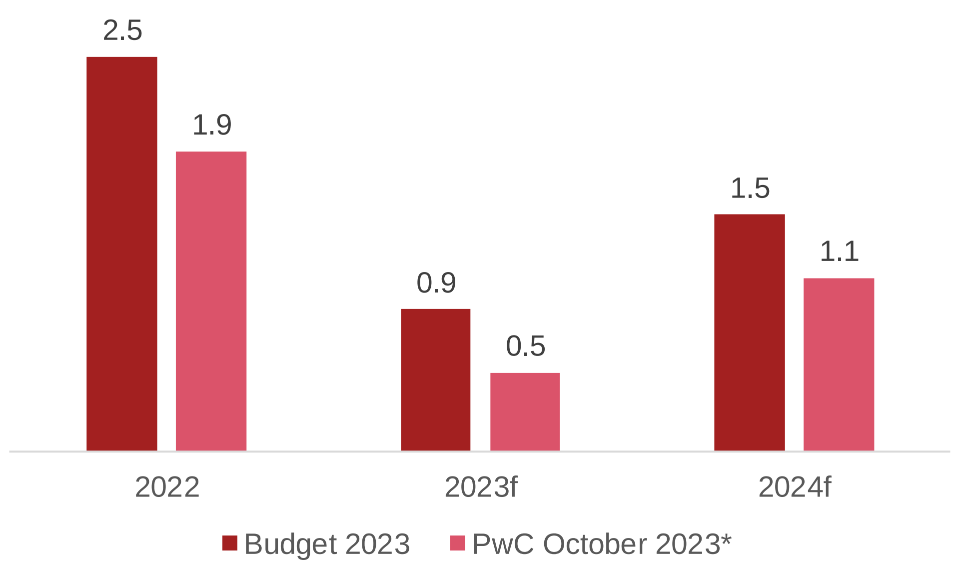
Inflation peaked at 7.8% y-o-y in July 2022. By the time Budget 2023 was released, headline inflation had declined to 6.9% y-o-y, with the National Treasury expecting inflation to average 5.3% during 2023. However, the headline reading climbed back to 7.1% y-o-y by March and remained outside the South African Reserve Bank (SARB) target range (3%-6%) until May. Several factors contributed to higher-than-expected inflation, including rand weakness, still-elevated global food price inflation, larger-than-expected fuel price increases, and the adverse effect of load-shedding on supply chains. This has resulted in slower disinflation — the decline in monthly y-o-y readings — compared to what many analysts were expecting earlier this year. For example, the SARB Monetary Policy Committee (MPC) said in January it expected inflation to average 5.9% in the second quarter of the year, compared to an actual figure of 6.2%.

Unsurprisingly, the SARB has had to respond accordingly with monetary policy moves. The MPC lifted interest rates by a cumulative 125 basis points in 2023 so far; more (by about 50 bps) than many economists had anticipated at the start of the year. This, in turn, has negatively impacted the broader economy. For example, higher interest rates have increased the cost of debt and the demand for credit. Private sector credit increased by only 4.4% y-o-y in August — the lowest since early-2020.

## GDP growth is underperforming due to pressure on household spending, business investment, and exports.

Budget 2023 expected the South African economy to grow by 0.9% this year and 1.5% in 2024. At present, we forecast lower growth rates of 0.5% and 1.1%, respectively.

*Figure 2: Real GDP growth (%)*




*Sources: National Treasury, PwC*

**PwC 2022 = actual Stats SA data*

This is indicative of the multiple headwinds faced by the local economy, For example, despite 2023 delivering slower inflation and an increase in employment, consumer sentiment measures show continued uncertainty at a household level. Data from the FNB/BER Consumer Confidence Index (CCI) shows that the household financial outlook indicator has not improved as the year progressed. For example, confidence amongst high-income individuals dropped to an all-time low in 2023Q2 due to a combination of factors weighing on their perspectives on South Africa's economic prospects. The BER listed the factors as follows: a significant escalation in load-shedding, a sharp depreciation in the rand exchange rate, continued increases in the SARB repo rate, and the diplomatic fallout following the docking of a Russian ship at the Simon's Town Naval Base.

Elsewhere, business confidence has not been strong enough to encourage investment in fixed assets. The RMB/BER Business Confidence Index (BCI) 2023Q3 determined that two-thirds of respondents to its survey were dissatisfied with prevailing business conditions. A glance at the Absa Purchasing Managers' Index (PMI) September 2023 provides a good summary of the challenges currently faced by the industrial sector and private sector in general: pressure on local and international demand, higher domestic interest rates, sharp increases in fuel prices, continued load-shedding, and longer supplier delivery times due to transport and other disruptions, amongst other factors.

Imported machinery and equipment — the type of equipment that companies invest in to grow their business — cost a significant 10.1% y-o-y more during July. This contributed to an increase in the country's import bill, with the South African Revenue Service (SARS) recording a 13.0% y-o-y increase in the value of total imports during the January-August 2023 period. While imports are part of the normal functioning of the economy, it must be remembered that they also create business activity in another country. Imports are, essentially, the exporting of jobs.

South Africa's trade surplus shrunk from R161bn in the first eight months of 2022 to R32bn in the same period of 2023. Global commodity prices (measured in US dollar) declined by 32% y-o-y in the second quarter of 2023 as global economic growth slowed. The prices of metals and minerals declined on average by 18% y-o-y during the second quarter of 2023. Coal prices, which rallied in 2022 on the back of greater demand from Europe as the region sought to replace energy imports from Russia, declined by 62% y-o-y in 2023Q2. South Africa also continued to struggle with the logistics of exporting: the SARB Composite Supply Chain Pressure Index (CSCPI) was in August this year still at a similar level to the pandemic-hit 2020Q2.

*We expect a total tax revenue shortfall of up to R30bn in 2023/2024. That is a significant improvement over an earlier prognosis — around R50bn — following strong collections of Corporate Income Tax (CIT) in August. The month of August is an important one for understanding the CIT landscape as it includes the first provisional tax payments for companies with February year-ends. Furthermore, collections of Personal Income Tax (PIT) are holding up well, and will likely be around R10bn above Budget 2023 estimates, on the back of stronger-than-expected job creation and wage growth.*

**Kyle Mandy**, PwC South Africa Tax Policy Leader

# Fiscal revenue shortfall: Likely smaller than initially expected after improved corporate tax receipts in August.

South Africa Economic Outlook October 2023

**Concerns about the size of the fiscal revenue shortfall in 2023/2024 have been tempered by better-than-expected (+10.4% y-o-y) corporate income tax collections in August — a key month for corporate tax receipts. Still, an expected total tax shortfall of up to R30bn this year would result in the tax buoyancy ratio (which measures the responsiveness of taxes to growth in the economy) falling to the lowest level since the global financial crisis.**

## It is still relatively early in the financial year to make accurate projections for full-year tax revenues.

There have been a lot of media reports and analyst comments over the past two months bout an expected large shortfall in tax revenues during the current (2023/2024) fiscal year. These forecasts have been wide-ranging because it is still relatively early in the financial year (only five months in terms of available data) to make accurate projections for tax revenues, with multiple forecast methodologies also used by different analysts. There is more than one way of looking at this question. Our approach is to look at collections in the financial year so far, and then compare these to previous years' historical periods. We can then compare current data with the share of total collections recorded in the first five months of the preceding fiscal periods.

Based on this approach, we now forecast a shortfall of approximately R10bn in Corporate Income Tax (CIT) collections compared to what was planned in Budget 2023. While CIT collections have declined by 15.1% y-o-y in the first five months (April-August) of 2023/2024, this is a smaller margin than previously calculated (-21.7%) when data was available up until July. August's CIT collections were 10.4% y-o-y higher. Generally, August is an important month for CIT collections due to companies with February year-ends making their first provisional tax payments. Note, however, that only two months of the fiscal year so far have been significant months for CIT collections, posing high risks to projections.

Still, from a CIT perspective, the is some good news at an industry level. PwC SA's Major Banks Analysis September 2023 noted that the country's four largest banks (Standard Bank, Absa, FirstRand, and Nedbank) paid R18.6bn in direct taxes in 2023H1, which was on par with the value seen in 2022H2 and 2022H1. In contrast, mining companies are contributing less tax following the end to the 2021-2022 commodity boom. The PwC SA Mine 2023 report determined that revenue earned by listed mining companies from ordinary activities declined by 10% in the year ending June 2023. With profit before interest and tax down 46%, their tax payments fell by R24bn (34%) to just R48bn.

On a positive note, PwC forecasts that Personal Income Tax (PIT) collections will exceed budgeted figures by around R10bn, with PIT growing at 8.0% y-o-y in the fiscal year so far against a budgeted increase of 6.7%. The better-than-expected PIT collections are partially being driven by higher-than-budgeted-for public sector wage increases: the government settled on a 7.5% wage agreement with public sector workers compared to a figure of 3.5% pencilled into Budget 2023. The country has also seen better-than-expected job creation in 2023 so far: total formal non-agricultural employment increased 6.9% y-o-y in 2023Q3.

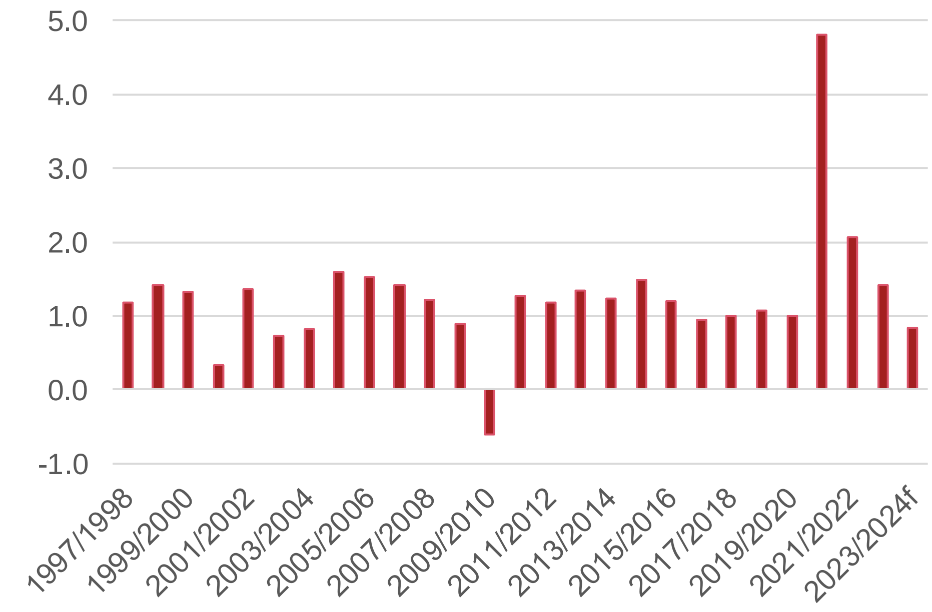
Also on a positive note, domestic Value-Added Tax (VAT) collections are holding up well, despite consumers being under severe pressure. Collections increased 6.5% y-o-y in 2023/2024 so far compared to a forecast growth rate of 7.5%. This could be a product of higher producer and consumer price inflation. VAT on imports also continues to outperform, increasing 14.9% y-o-y against a budgeted fall of 1.5%. This growth is driven largely by imports of solar panels and other alternative power supplies in light of the country's electricity crisis. In contrast to the above positive data, VAT refunds have increased 13.5% y-o-y against a budgeted fall of 5.1%. The growth in VAT refunds is driven by significant capital investment by businesses, also presumably to insulate their operations against load-shedding. As a result of this big rise in refunds, PwC forecasts a shortfall in net VAT collections of between R15bn and R30bn for the current year.

## Tax buoyancy ratio could decline to the lowest level since the global financial crisis.

We expect a total tax revenue shortfall of up to R30bn in 2023/2024. This is a significant improvement over an earlier prognosis — around R50bn estimated in September — following the strong collections of CIT during the important month of August. The expected shortfall this year is smaller than the gaps (between R50bn and R70bn) recorded in the three years ahead of COVID-19. However, there are significant downside risks to the overall 2023/2024 shortfall forecast, specifically for CIT, due to economic challenges such as low economic growth, high unemployment, and volatility in the mining sector.

A R30bn tax gap would result in a tax buoyancy ratio of 0.84 in 2023/2024. This would be the lowest reading since the global financial crisis. Tax buoyancy measures the responsiveness of taxes to growth in the economy. A reading below 1 indicates that tax revenue growth is lower than nominal GDP growth.

*Figure 3: Tax buoyancy ratio*




*Source: PwC*

# Narrowing the funding gap: Banking on greater tax compliance to improve the medium-term fiscal outlook.

South Africa Economic Outlook October 2023

**The MTPBS 2023 needs to update fiscal revenue, expenditure and debt forecasts, and specifically comment on how the 2023/2024 funding gap will be addressed. The finance minister has indicated that spending cuts and increased borrowing (not higher taxes) can be expected. PwC also anticipates that the minister will place greater responsibility on SARS to improve compliance levels to bolster fiscal income over the medium-term.**

## Expenditure has continued to grow despite the Treasury asking accounting officers and authorities to save money.

The minister of Finance Enoch Godongwana will deliver the MTBPS 2023 on 1 November. He has been hard at work in recent months trying to make plans for reducing the expected fiscal income gap. This includes guidelines published by the National Treasury in mid-September on cost containment measures for the 2023/2024 fiscal year. This, in turn, followed the National Treasury issuing a letter in late-August to national government departments and provincial treasuries advising accounting officers and authorities "on specific measures required to achieve much-needed savings and prevent the materialisation of potentially crippling resource constraints" in the latter part of the fiscal year. However, monthly government income and spending data up to September indicates that expenditure has continued to grow. With this in mind, analysts surveyed by Focus Economics expect the budget deficit to grow to 5.5% of GDP this year (median forecast), compared to a Budget 2023 projection of 4.0% of GDP.

The finance minister will need to make tough choices about how the 2023/2024 fiscal revenue gap (which we estimate at up to R30bn) and a more conservative income outlook for the rest of the medium term will be addressed. Generally speaking, there are three options for closing a fiscal funding gap, as summarised in Table 1.

*Table 1: Options to close the fiscal funding gap*

| Spend less |
|---|
| Budget overruns, resulting from factors such as the higher-than-planned wage increase and other unfunded budget proposals, could be funded within the existing expenditure framework, as the National Treasury previously indicated. However, a reduction in spending by government departments is needed to reduce overall expenditure — hence the letter that the National Treasury issued in late-August. Higher deficits resulting from revenue shortfalls and other expenditure overruns would most likely be funded by way of further expenditure cuts. The traditional method for budget cuts has been the across-the-board approach. It has also been proposed by the National Treasury that entire programmes and departments might need to be cut in order to meet budget goals. However, this will take time to implement and is not possible during 2023/2024. |
| **Borrow more** |
| Debt financing can be obtained by the government to fund the shortfall and additional expenditure. Higher deficits resulting from revenue shortfalls and expenditure overruns could be funded through more debt issuance and a higher debt peak. However, global financial conditions are not favourable, with demand for funding by developed countries outpacing the emerging world. Alongside this, South Africa's failure to implement significant structural reforms has resulted in the country's favoured position by international investors dwindling substantially. Offshore funding also carries exchange rate risks. As such, even though we may find credit, it is likely to come at a notable premium. The finance minister said in mid-October that any additional borrowing will be done in "a sustainable way", and he will need to detail this in early-November. |
| **Increase taxes** |
| The National Treasury has indicated that there may be a need for an increase in tax rates if government departments do not reduce spending, especially on headcount. South Africa already has relatively high CIT and PIT rates and a relatively small number of taxpayers to carry the bulk of the tax burden, making it unlikely that the state will increase taxes here. An increase in VAT remains an option, given that the local rate (15%) is below the global average (19%). There are, however, sensitivities around this type of tax given that it is not a progressive tax. Nonetheless, the National Treasury could look to justify increasing the VAT rate should they need to find additional revenues to fund a Basic Income Grant (BIG) on the basis that the net result is highly progressive. Previous tax rate increases did not translate into the expected additional revenues, with economic conditions only deteriorating further since then as South Africa continues to struggle in a low-growth environment. As such, we believe increasing tax rates will be one of the last options considered by the finance minister. Also, the government has never increased taxes in the middle of a fiscal year and has only ever announced tax increases in the MTBPS for the next fiscal year in exceptional circumstances. |

## What we expect MTBPS 2023 will announce to address funding challenges in 2023/2024 and beyond.

Minister Godongwana told Parliament on 17 October that "moderate" spending cuts and a "sustainable" increase in borrowing will be implemented to narrow the income gap in 2023/2024. However, this does not remedy the problem of the government frequently receiving less income than it expects to see. PwC believes the most likely response to the need for improving revenues over the medium term would be — as a fourth option for closing a fiscal funding gap — placing greater responsibility and pressure on SARS to improve tax compliance levels. The country's tax gap (the difference between taxes legally owed and taxes collected) is currently estimated to be more than R300bn. Reducing this by 10% would fund the tax shortfall of R30bn that we have forecast for 2023/2024.

**10%**

South Africa's tax gap is currently estimated to be more than R300bn. Reducing this by 10% would fund the tax shortfall of R30bn that we have forecast for 2023/2024.

Budget 2023 already noted that a portion of revenue collection improvement was due to improved tax compliance. SARS deputy commissioner Johnstone Makhubu has noted that compliance efforts contributed R82bn to revenues in the first five months of the year, up 22% y-o-y. However, despite positive developments, the institution still has a long way to go towards significantly reducing the tax gap. Acquiring additional resources would only be one of the essential steps needed to make significant progress on this front. SARS commissioner Edward Kieswetter has said that his organisation should be excluded from any spending cuts proposed in the MTBPS. A statement we agree with.

# PwC Economics services and contacts.

South Africa Economic Outlook October 2023

## How we can help.

Fiscal revenues are under pressure. This, in turn, adds more challenges to public service delivery during a time of elevated socio-economic strain in the country. The public sector is overwhelmed; stretched in every direction to cope with these and other challenges. However, with this statement, we also deliver a message of hope. South African companies can make a meaningful and sustainable impact on their communities by partnering with the government to help the state address socio-economic challenges.

PwC has been involved in the development of an alternative model to the traditional Public-Private Partnership (PPP) which is being implemented in a number of large infrastructure projects in South Africa. The public-private collaboration model is premised on an equal partnership basis with each entity, with the government and private sector providing shared funding and having shared control over the assets. This approach supports the government in executing its mandate of public service delivery and provides private entities with a social licence to operate. This collaboration approach can find applications in water, sanitation, transport and energy infrastructure projects.

From a financing perspective, the new collaboration model involves innovative funding models that reduce the impact on the fiscus. At the same time, ownership of the relevant infrastructure assets resides with the government. To ensure strong governance structures and equal participation by both the public and private sector parties, an independent execution body with representation of all partners to the model is set in place with appropriate governance structures. Collaboration and strong relationships, combined with a focus on community needs, are key for the successful roll-out of infrastructure and associated socio-economic development programmes.

## Our services

The PwC South Africa Strategy& Purpose-Led Economics team is a specialised unit of economists who serve our clients in a variety of ways. Our services include:

Measure your impact on the economy and society

- Environmental, Social and Governance (ESG) and Just Transition
- Economic Impact Assessment (EIA)
- Socio-Economic Impact Assessment (SEIA)
- Regulatory Impact Analysis (RIA)
- Total tax contribution
- Localisation calculations

Make decisions about risk and investment

- Macroeconomic research
- Market entry analysis
- Country and industry risk assessments
- Commercial due diligence assistance

Plan for future economic scenarios

- ESG scenario planning
- Economic and political scenario planning
- Industry and macroeconomic modelling
- IFRS 9 audit assist

Please visit our website to learn more:
https://www.strategyand.pwc.com/a1/en/solutions/purpose-led-economics.html


**Lullu Krugel**

*Partner and Chief Economist*

lullu.krugel@pwc.com

+27 82 708 2330

**Dirk Mostert**

*Director*

dirk.mostert@pwc.com

+27 82 800 9326

**Salome Ntsibande**

*Senior Manager*

salome.ntsibande@pwc.com

+27 72 210 1013

**Christie Viljoen**

*Senior Manager*

christie.viljoen@pwc.com

+27 82 472 8621

**Xhanti Payi**

*Senior Manager*

xhanti.payi@pwc.com

+27 82 072 9461