

2019 MTBPS

MEDIUM TERM BUDGET
POLICY STATEMENT

GROWTH, SUSTAINABILITY
AND RENEWAL



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA



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1. Overview



Medium - Term Budget Policy Statement Overview

The 2019 Medium-Term Budget Policy Statement (MTBPS) proposes an approach over the medium term that, effectively implemented, will restore the momentum of economic growth and stabilise the public finances

GDP growth

- Economic growth is now projected at 0.5% for 2019
- As a result, revenue projections have been sharply reduced. Spending pressures continue to mount, led by the public service wage bill and certain State-Owned Companies (SOCs)

Government spending

- Over the next three years, consolidated spending will total R6.3tn, with 48% of this amount going towards social grants, education and health

Budget Deficit

- The consolidated budget deficit averages 6.2% of GDP over the next three years
- Debt and debt-service costs will continue to increase, with the debt-to-GDP ratio now estimated at 71.3% in 2022/23

Revenue

- Government has clawed back some of the revenue shortfall through reductions to departmental baselines and slower spending growth in 2022/23
- Additional measures, particularly on the wage bill, will be required to stabilise the debt outlook and improve the composition of spending. Tax measures are also being considered

Short- and medium-term reforms

- National Treasury (NT) released a paper outlining short- and medium-term reforms that can boost economic growth
- Interventions to improve the quality of infrastructure planning are beginning to show some results. Further measures to reduce wasteful expenditure will be implemented in the coming year

Support to Eskom

- Government is providing medium-term support to Eskom to secure energy supply and to honour the state's contractual obligations
- NT, in partnership with the Department of Public Enterprises (DPE), is instituting a series of measures to bring discipline to the utility's finances, and to step up the timeline for restructuring



2. Macro Economic Developments



World Economic Growth is Slowing

- Lower growth in both developed and developing economies in response to mounting global risks
- Global economic growth in 2019 projected at 3%, the lowest figure since The 2008 Financial Crisis
- Relative to the 2018 average, South Africa's risk premium has risen by about 0.3 percentage points, compared to an average decline of 0.3 percentage points in peer countries

Economic growth in selected countries					
Region/country	2018	2019	2020	2021	2022-2024
Percentage	Actual	Average GDP (forecast)			
World	3.6	3.0	3.4	3.6	3.6
Advanced economies	2.3	1.7	1.7	1.6	1.6
United States	2.9	2.4	2.1	1.7	1.6
Euro area	1.9	1.2	1.4	1.4	1.3
United Kingdom	1.4	1.2	1.4	1.5	1.5
Japan	0.8	0.9	0.5	0.5	0.5
Developing countries	4.5	3.9	4.6	4.8	4.8
China	6.6	6.1	5.8	5.9	5.6
India	6.8	6.1	7.0	7.4	7.4
Brazil	1.1	0.9	2.0	2.4	2.4
Russia	2.3	1.1	1.9	2.0	1.9
Mexico	2.0	0.4	1.3	1.9	2.3
Sub-Saharan Africa	3.2	3.2	3.6	3.7	4.1
South Africa ¹	0.8	0.5	1.2	1.6	1.7

1. National Treasury forecasts. Note: Final numbers are for 2022

Source: IMF World Economic Outlook, October 2019, and IMF World Economic Outlook database

Domestic Growth Outlook is Revised Down

- 2019 GDP growth revised down from 1.5% at the time of the 2019 Budget, to 0.5%, mainly reflecting weaker total investment, exports and global growth
- The current account deficit is expected to remain at 3.5% of GDP over the next three years, reflecting low import growth due to weaker domestic demand

Macroeconomic performance and projections

Calendar year	2017	2018	2019	2020	2021	2022
Percentage change	Actual		Estimate	Forecast		
Final household consumption	2.1	1.8	1.3	1.3	1.5	1.7
Final government consumption	0.2	1.9	1.8	1.8	1.1	0.6
Gross fixed-capital formation	1.0	-1.4	-0.8	0.8	1.3	1.8
Gross domestic expenditure	1.9	1.0	1.4	1.1	1.5	1.7
Exports	-0.7	2.6	-1.7	2.5	2.8	3.1
Imports	1.0	3.3	1.1	1.9	2.6	3.0
Real GDP growth	1.4	0.8	0.5	1.2	1.6	1.7
GDP inflation	5.3	3.9	4.8	4.9	4.9	4.8
GDP at current prices (R billion)	4 654	4 874	5 132	5 449	5 804	6 187
CPI inflation	5.3	4.7	4.3	4.9	4.8	4.8
Current account balance (% of GDP)	-2.5	-3.5	-3.4	-3.5	-3.5	-3.5

Source: National Treasury, Reserve Bank and Statistics South Africa

Economic Reforms Urgently Required to Raise GDP Growth

- Discussion document titled *Economic Transformation, Inclusive Growth, and Competitiveness: Towards an Economic Strategy for South Africa* sets out short- and medium-term growth reforms
- Short-term reforms can be implemented immediately, without significant state resources:
 - **Support tourism** by reducing cost of traveling to South Africa, cutting red tape for small business in the tourism sector
 - **Diversify power generation** by granting licences for small-scale power generation projects approved by the Minister of Energy
 - **Expand telecommunications services** by allowing the rapid expansion of fibre infrastructure
 - **Lowering the cost of doing business** by automating registration and filing processes
- Medium-term reforms should begin immediately in transport, water, telecommunications, and industrial and trade policy
- Government continues to work with private sector to strengthen investment
 - The Infrastructure Fund's implementation unit has been established, housed within the Development Bank of South Africa (DBSA)
 - Review of public-private partnership regulation is under way to streamline approval processes and reduce implementation timeframes

3. Fiscal Outlook



Fiscal Framework

- The consolidated deficit includes national and provincial government, public entities and social security funds
- The consolidated deficit narrows from 6.5% in 2020/21 to 5.9% in 2022/23

Consolidated government fiscal framework

	2018/19	2019/20	2020/21	2021/22	2022/23
R billion/percentage of GDP	Outcome	Revised	Medium-term estimates		
Revenue	1 445.4	1 537.8	1 618.5	1 729.6	1 841.2
	29.4%	29.5%	29.3%	29.4%	29.3%
Expenditure	1 652.8	1 844.1	1 978.7	2 097.5	2 214.9
	33.6%	35.4%	35.8%	35.6%	35.3%
Budget balance	-207.5	-306.2	-360.2	-367.9	-373.7
	-4.2%	-5.9%	-6.5%	-6.2%	-5.9%
Total gross loan debt	2 788.4	3 167.6	3 590.8	4 035.7	4 477.7
	56.7%	60.8%	64.9%	68.5%	71.3%

Source: National Treasury

Revenue Outlook

- Compared with the 2019 Budget estimates, total revenue shortfall for 2019/20 will amount to R52.5bn, reflecting:
 - A poor employment outlook, with job losses, lower wage settlements and smaller bonuses reducing personal income tax collection
 - Reduced profitability in a difficult trading environment, resulting in lower-than-expected corporate income tax collections
 - Weak household consumption, which moderates the increase in domestic VAT collection
- Large downward revisions to tax revenue over the medium term

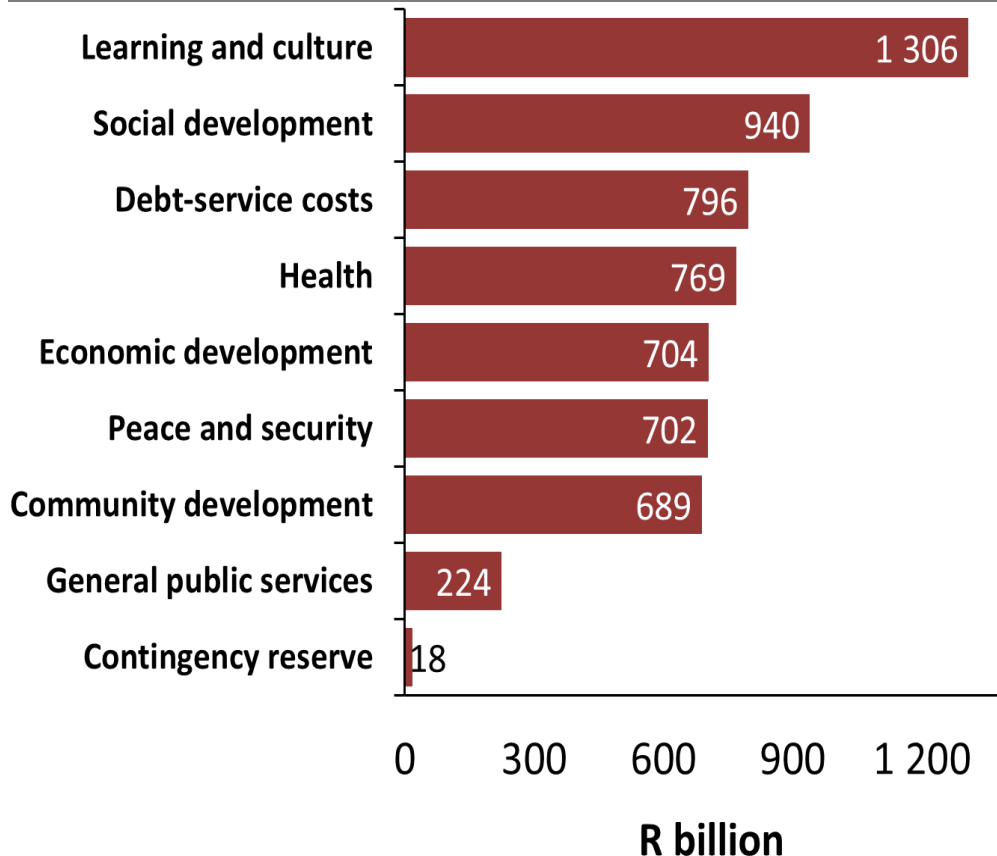
Revised revenue projections

R billion	2019/20	2020/21	2021/22	2022/23
2019 Budget	1 422.2	1 544.9	1 670.4	
<i>Buoyancy</i>	<i>1.31</i>	<i>1.17</i>	<i>1.08</i>	
Revised estimates	1 369.7	1 460.9	1 555.7	1 658.2
<i>Buoyancy</i>	<i>1.08</i>	<i>1.09</i>	<i>0.99</i>	<i>1.00</i>
Change since 2019 Budget	-52.5	-84.0	-114.7	

Source: National Treasury

Expenditure Priorities

Consolidated government expenditure by function 2020/21 – 22/23



- Consolidated government spending is expected to total R6.3tn over the MTEF period, growing at an average annual growth rate of 6.3%
- Learning and culture, social development and health receive the largest allocations, amounting to R3tn over the next three years
- By 2022/23, debt-service costs are expected to exceed spending in areas such as health and economic development

Source: National Treasury

In-Year Main Budget Non-Interest Expenditure Adjustments

Revisions to 2019/20 main budget non-interest expenditure

	R million
Non-interest expenditure (2019 Budget Review)	1 456 500
Upward expenditure adjustments	44 527
Budget Facility for Infrastructure projects and project preparation	630
Financial support to SOCs:	
Eskom Special Appropriation Bill	26 000
South African Airways	5 500
South African Broadcasting Corporation	3 200
Denel	1 800
South African Express	300
Self-financing ¹	1 655
Provisional downward adjustment not effected on compensation	4 800
Roll-overs	345
National Revenue Fund payments adjustment	224
Revision to members of Parliament remuneration	73
Downward expenditure adjustments	(21 405)
Declared unspent funds and revision to magistrates' salaries	(4 029)
Contingency reserve	(13 000)
Skills development levy	(182)
Provisional allocation not assigned to votes	(1 010)
National government projected underspending	(1 184)
Local government repayment to the National Revenue Fund	(2 000)
Revised non-interest expenditure (2019 MTBPS)	1 479 622
Change in non-interest expenditure from 2019 Budget	23 122
Change in non-interest expenditure excluding Eskom	(2 878)

1. Spending financed from revenue derived from departments' specific activities

Source: National Treasury



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- Non-interest spending has increased by R23bn in the current year, mainly due to a Special Appropriation Bill that allocates R26bn to Eskom
- Government has accommodated all other expenditure pressures within budget baselines
- In-year adjustments are partially offset by the use of the contingency reserve, provisional allocations, projected underspending and declared unspent funds

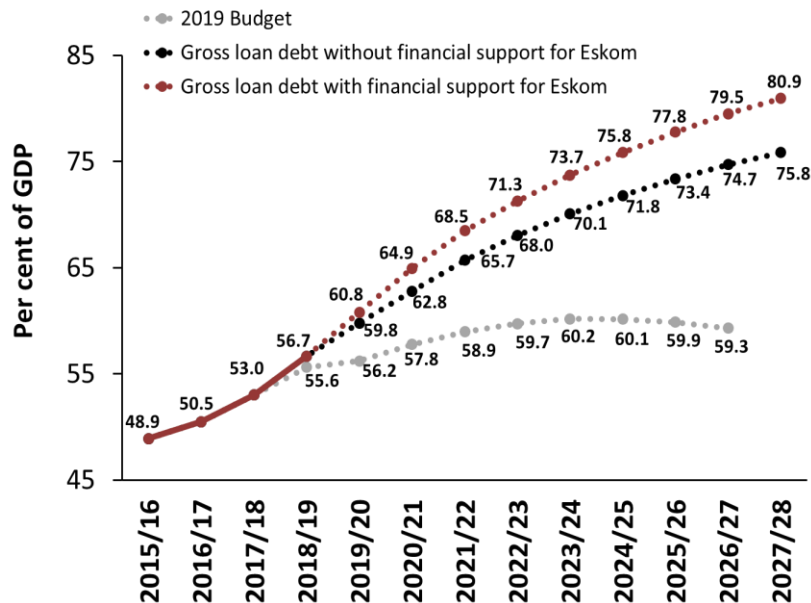
Medium-Term Non-Interest Expenditure Adjustments

- Relative to the 2019 Budget, main budget non-interest expenditure increases by R23bn in 2020/21, and decreases by R8.2bn in 2021/22. These net changes include:
 - 1** ■ Increases in non-interest spending of R45bn and R22bn over the next two years, mainly as a result of additional support to Eskom
 - 2** ■ Reductions of R21bn in 2020/21 and R28.5bn in 2021/22, mostly falling on goods and services, and current and capital transfers
 - Compensation is revised down marginally in line with lower consumer price index inflation (CPI) projections
- The expected savings from compensation and other measures announced in the 2019 Budget – amounting to R12bn annually over the next two years – have been reversed
 - Compensation measures will be included in a broader discussion between government and labour on future adjustments to wage bill growth
- In 2022/23, main budget non-interest spending will be contained in line with CPI

Main Budget Primary Deficit and Debt Outlook

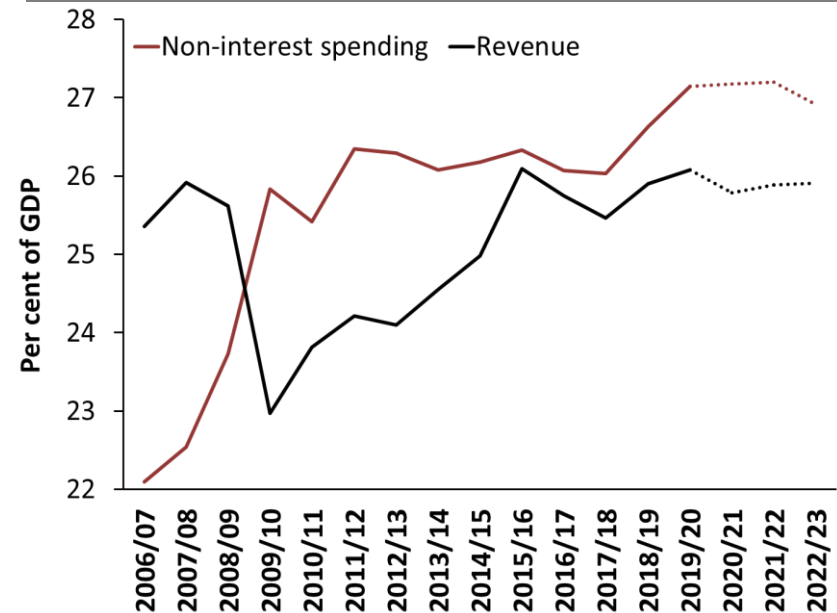
- Real main budget non-interest spending grows at 1.2% in 2020/21, 0.1% in 2021/22, and -0.2% in 2022/23
- Main budget primary deficit narrows to 1.4% of GDP in 2022/23
- Debt-to-GDP reaches 71.3% in 2022/23 and, without additional measures, will continue to grow

Gross debt-to-GDP outlook



Source: National Treasury

Main budget primary balance*



Source: National Treasury

*Excluding Eskom financial support and transactions in financial assets and liabilities

Additional Measures Required to Stabilise the Public Finances

- Government proposes a fiscal target of achieving a main budget primary balance – in other words, revenue equal to non-interest expenditure – by 2022/23. This metric excludes financial support for Eskom, which will be addressed through separate operational and financial reforms
- Achieving the fiscal target requires large additional adjustments exceeding R150bn in total over the medium term. The following elements will be critical:

Decline of the public-service wage bill

Growth in the public-service wage bill needs to decline to reduce the pressure on goods and services and infrastructure. The wage bill accounts for 46% of tax revenue in 2019/20, primarily because of above-inflation increases in average remuneration over the past decade

Additional tax measures

Significant tax increases over the past several years leave only moderate scope to boost tax revenue at this time. Given the size of the required adjustment, however, additional tax measures are under consideration

Sustainable plan for SOCs

To reduce future transfers, a sustainable plan for SOCs is required. It should include the disposal of non-core assets and options for private-sector participation

- The final adjustments will be announced in the 2020 Budget
- These measures require difficult decisions that will affect the economy and the distribution of public resources

Improving Spending Efficiency and Reducing Waste

- To bolster efforts to combat corruption and improve revenue collection through reprioritisation, the National Prosecuting Authority receives an additional R1.3bn and the South African Revenue Service receives an additional R1bn for the period 2019/20 to 2022/23
- In order to improve efficiency and reduce wasteful expenditure, government will:

1

Standardise the regulation of development charges through the Municipal Fiscal Powers and Functions Amendment Bill, which will be tabled shortly

2

Suspend implementation of new public transport networks in cities that have been in the planning stage for over a decade with no roll-out of services to residents

3

Merge and consolidate entities and regulatory agencies, and dispose of unused land and other assets

4

Initiate work to limit claims against the state, including through a review of medico-legal claims and accelerated implementation of the Road Accident Benefit Scheme

5

Manage benefits received by political office bearers, through reforms to the Ministerial Handbook

6

Review existing procurement regulatory framework, through the Public Procurement Bill, to simplify procurement processes and governance

4. Financing of Borrowing Requirement



Total National Government Debt

Total National Government Debt 2018/19– 2022/23

End of period	2018/19	2019/20	2020/21	2021/22	2022/23
R billion	Outcome	Revised	Medium-term estimates		
Domestic loans¹	2 497.1	2 849.2	3 229.0	3 624.1	4 026.3
Short-term	324.6	370.6	407.6	457.6	515.6
Long-term	2 172.5	2 478.6	2 821.4	3 166.5	3 510.7
<i>Fixed-rate</i>	1 604.8	1 833.1	2 076.3	2 370.9	2 596.0
<i>Inflation-linked</i>	567.7	645.5	745.1	795.6	914.7
Foreign loans¹	291.3	318.4	361.8	411.6	451.4
Gross loan debt	2 788.4	3 167.6	3 590.8	4 035.7	4 477.7
Less: National Revenue Fund bank balances	-243.1	-243.6	-232.7	-235.4	-234.7
Net loan debt²	2 545.3	2 924.0	3 358.1	3 800.3	4 243.0
<i>As percentage of GDP:</i>					
<i>Gross loan debt</i>	56.7%	60.8%	64.9%	68.5%	71.3%
<i>Net loan debt</i>	51.7%	56.1%	60.7%	64.5%	67.5%

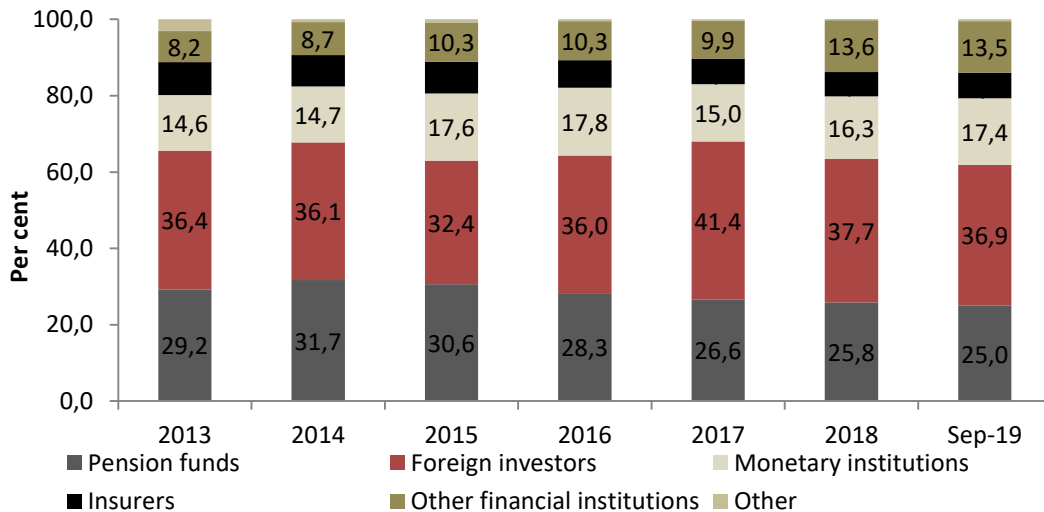
1. Estimates include revaluations based on National Treasury's projections of inflation and exchange rates

2. Net loan debt is gross loan debt minus the bank balances of the National Revenue Fund

Source: National Treasury

Foreign Investors Marginally Increase Holdings

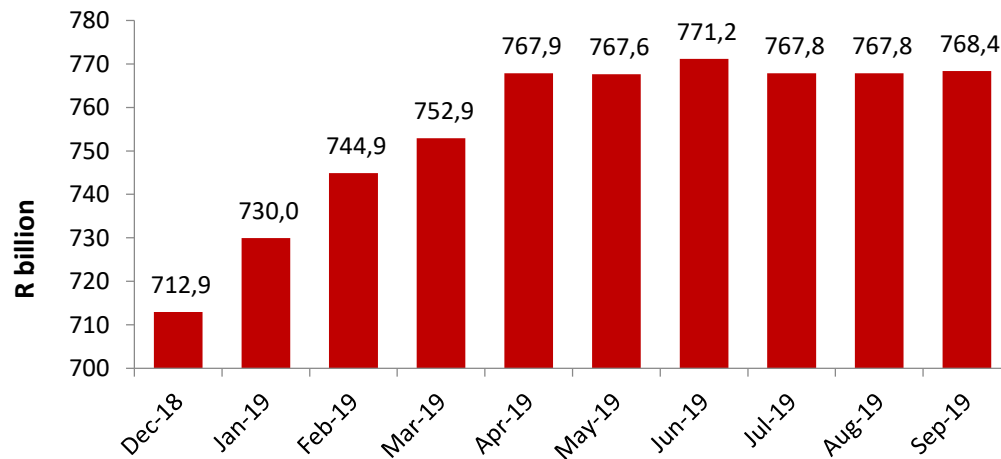
Holdings of domestic government bonds, 2013 – Sept 2019



- Foreign investor holdings decreased from 37.7 per cent in December 2018 to 36.9 per cent in September 2019 while domestic financial institutions increased their holdings

- Nominal holdings are at R768 billion with a net inflow of R16 billion for this fiscal year
- Although global monetary conditions are positive for high yielding assets, foreign investors have been cautious about increasing their holdings of South African local government debt

Non-residents domestic government bond holdings, Dec 2018 – Sept 2019



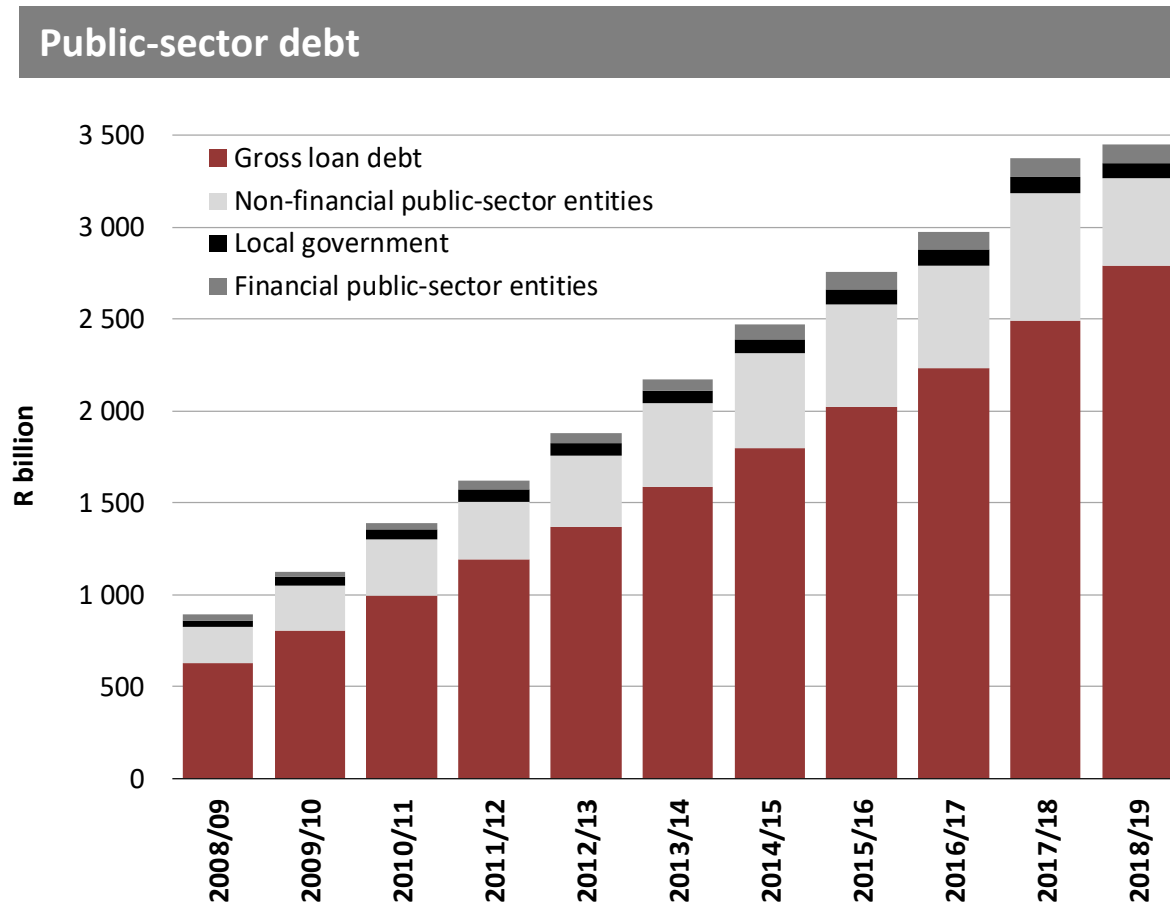
Source: Share Transaction Totally Electronic LTD(Strate)

5. State-owned Companies and Other State Institutions



Foreign Investors Marginally Increase Holdings

- Several SOCs are facing difficulties as a result of governance failures, poor operational performance and resultant unsustainable debt burdens
- SOCs debt has grown alongside government debt
- Government has increased spending to meet its obligations for guaranteed debt, but decisions are required to manage the ongoing impact of these entities on the fiscus
- A programme of reforms is being enacted to strengthen governance and operations at these entities, and to stabilise those in financial distress



Source: National Treasury

Interventions to Stabilise Eskom and Other SOCs

Eskom's Turnaround Strategy

- Government is committed to the separation of Eskom into three functions (generation, transmission, distribution) in conjunction with necessary organisational reforms to achieve operational efficiency
- The immediate priority is to stabilise Eskom's cash-flow management, while undertaking the separation
- Government has made provisional support of R49bn available in 2019/20, R56bn in 2020/21 and R33bn in 2021/22.
- Additional reforms to reduce Eskom's debt burden will only be considered once the utility reduces costs and makes progress in the unbundling process

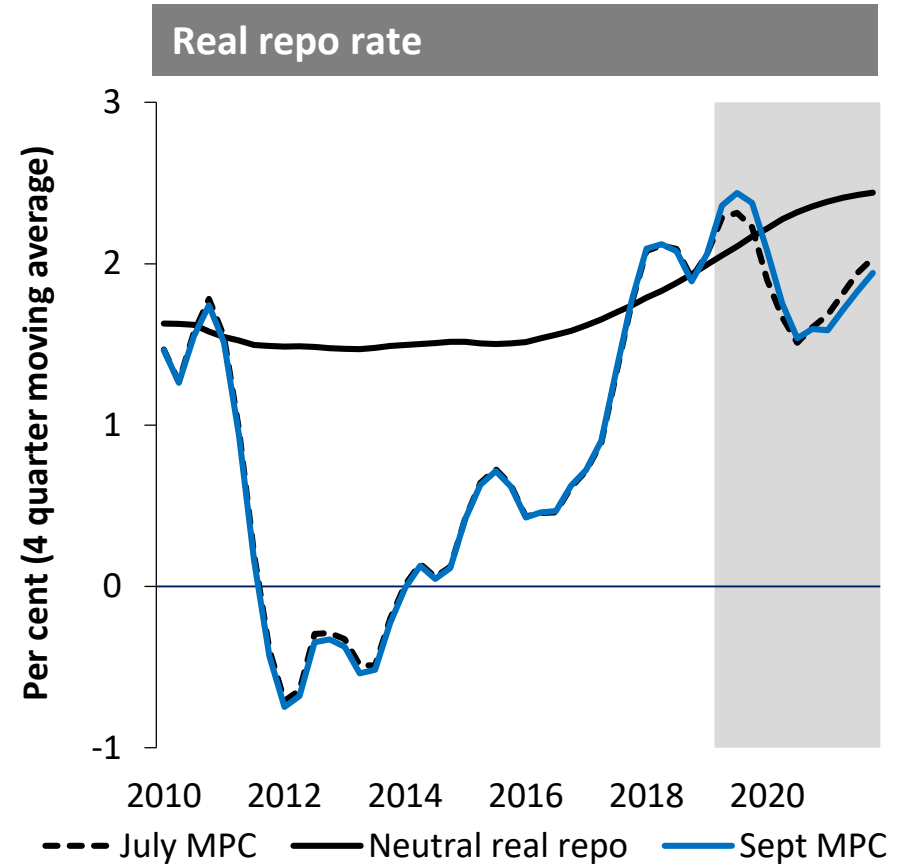
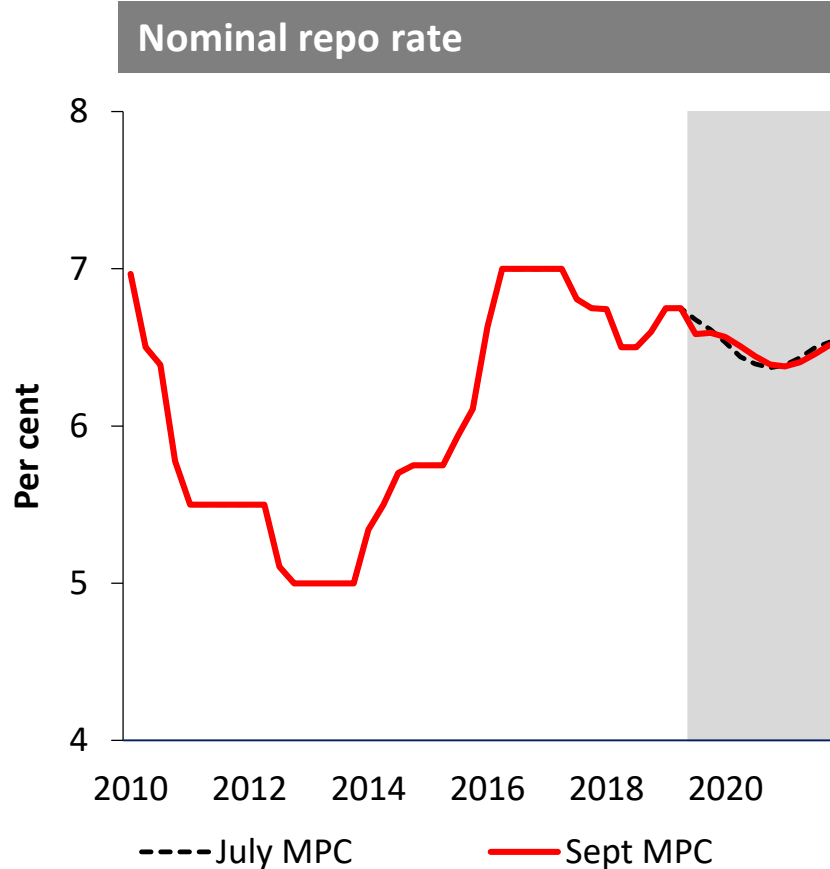
Support for other SOCs

- Government is initiating a series of major reforms at SOCs aimed at adjusting business models and response to changed economic conditions, restore good governance, bolster operational efficiency and strengthen financial controls and planning
- Funding for South African Airways (SAA), the South African Broadcasting Corporation, Denel and South African Express amounts to R10.8bn in the current year
- Government will repay SAA's outstanding government guaranteed debt of R9.2bn over the next three years to honour its contractual obligation

6. Monetary Policy



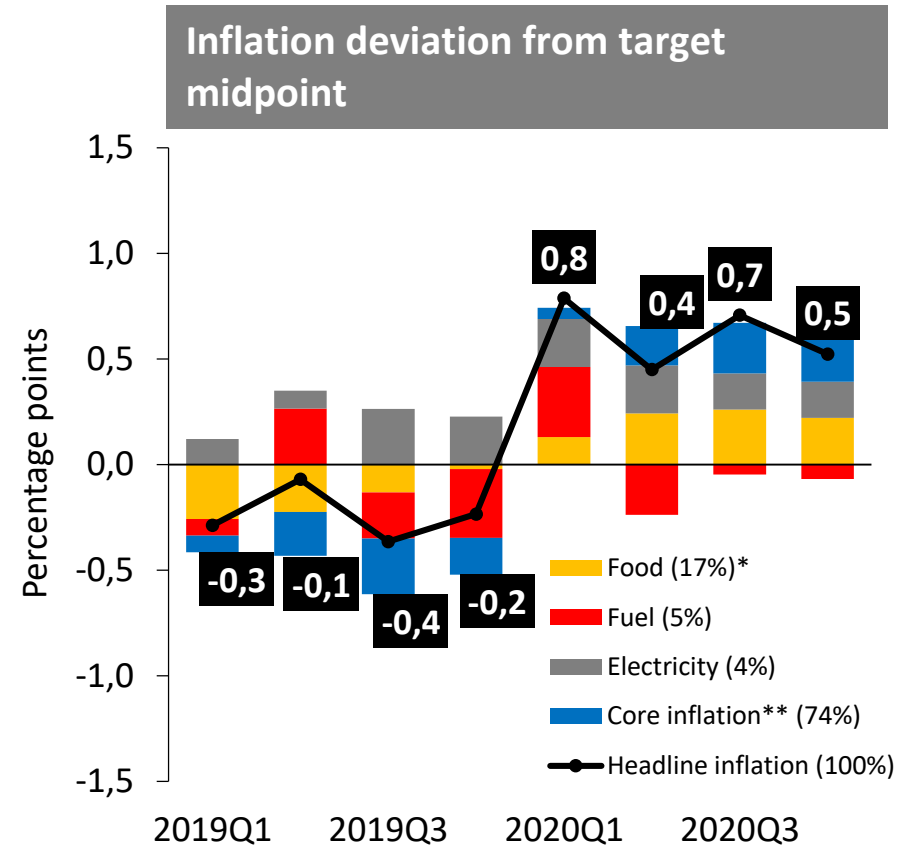
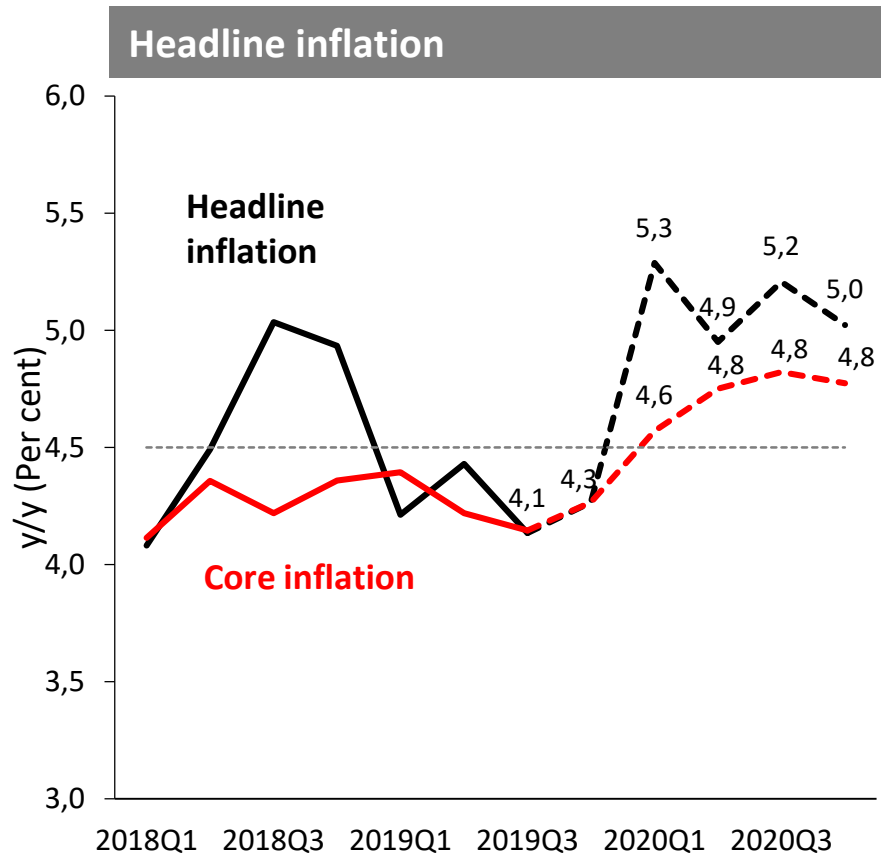
Taylor Rule Signals no Further Repo Rate Cuts



	2019Q1	2019Q2	2019Q3	2019Q4	2020Q1	2020Q2	2020Q3	2020Q4	2021Q1	2021Q2	2021Q3	2021Q4
July 2019 MPC	6.75	6.75	6.68	6.61	6.53	6.44	6.39	6.37	6.39	6.43	6.50	6.53
Sept 2019 MPC	6.75	6.75	6.58	6.59	6.57	6.51	6.44	6.39	6.38	6.41	6.46	6.52

Source: SARb

Inflation Outcomes Temporarily Below 4.5% Rising Above Early Next Year



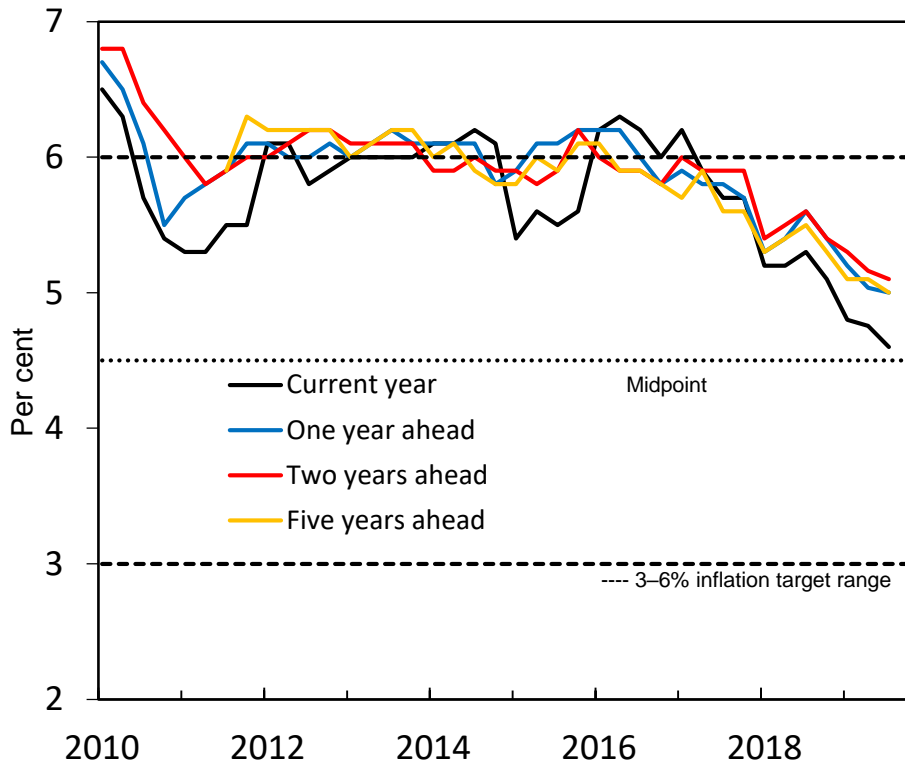
*Figures in brackets are CPI weights

**Headline inflation excluding food, fuel and electricity

Source: SARB

Inflation Expectations Moderating – Focus on Trend & Level

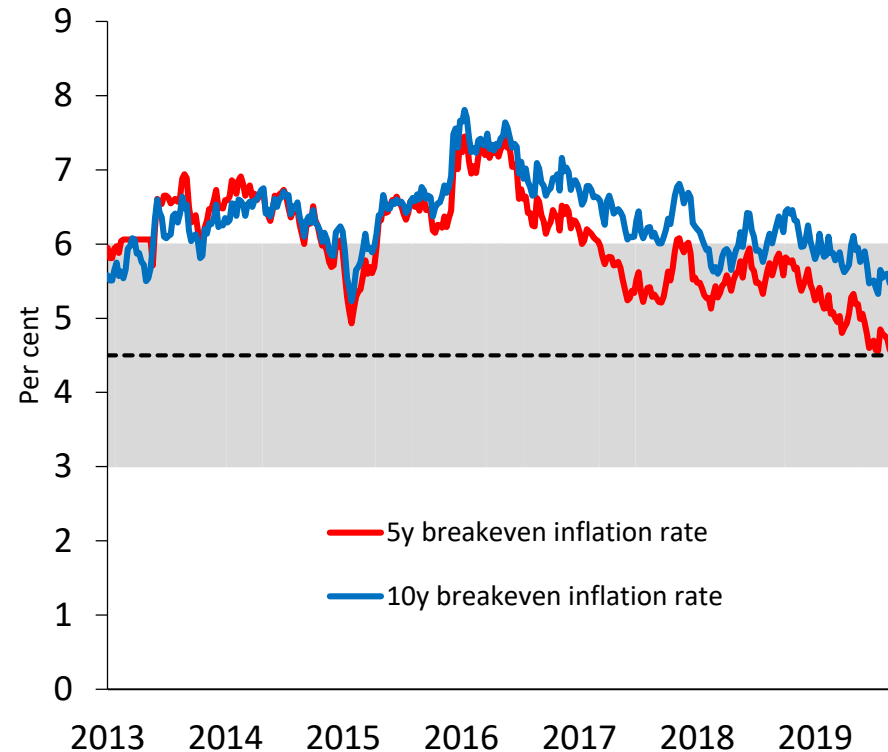
Surveyed inflation expectations*



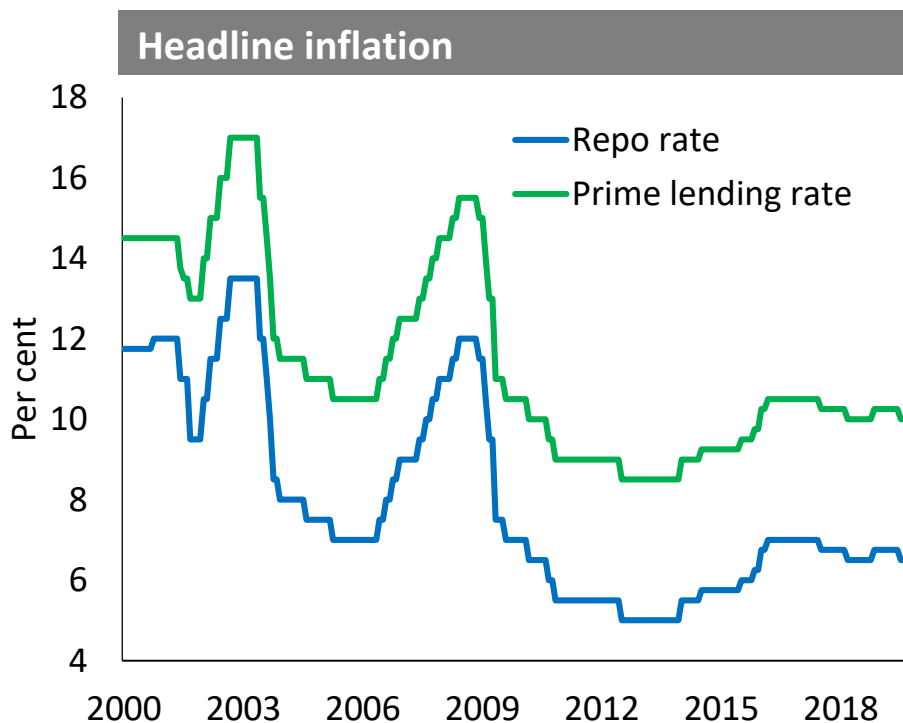
* Average of labour, business and analyst expectations

Sources: BER and SARB

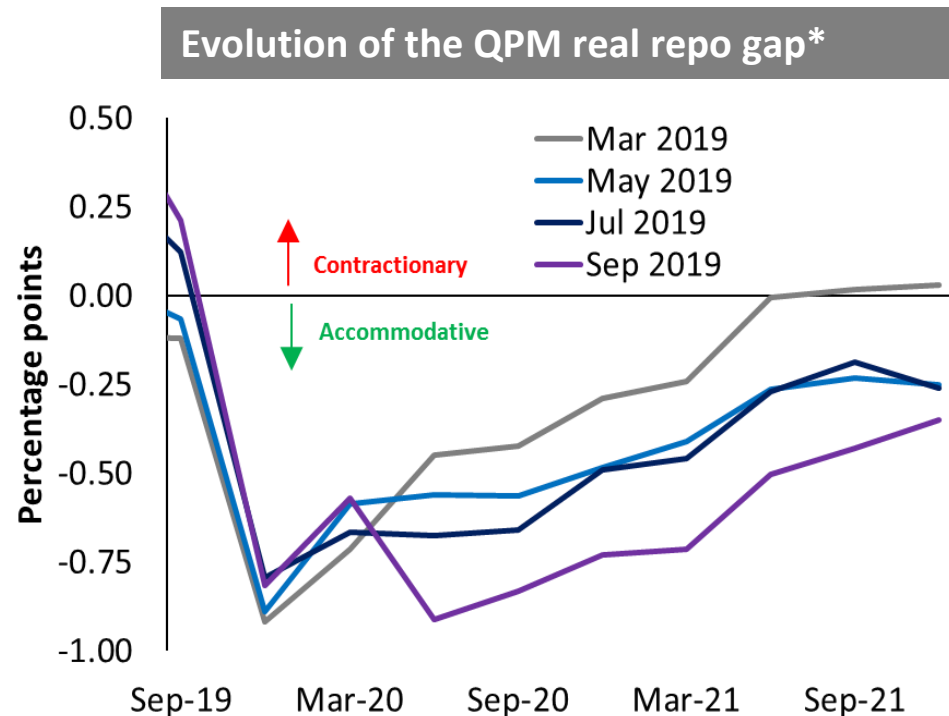
Market-implied inflation expectations



Lower Inflation Provided Some Policy Space | Real Repo Mostly Around the Neutral Rate



Source: SARB



*Real repo gap is the real repo rate (nominal repo deflated by 1q ahead inflation) less the neutral real interest rate.

Source: SARB

7. Conclusion



Conclusion

1

Growth Outlook

- South Africa's growth outlook has been revised down sharply, and revenue shortfalls for 2019/20 — 2021/22 remain significant. The deficit is expected to widen substantially over the next three years relative to 2019 Budget estimates. Debt and debt-service costs will continue to increase

2

Government Spending

- Over the medium term, consolidated spending will total R6.3tn, with 48% of this amount going towards social grants, education and health. The worsening fiscal position is threatening government's ability to maintain existing levels of service provision and infrastructure investment

3

Stabilizing Debt-to-GDP

- Government is proposing a fiscal target: a main budget primary balance, excluding financial support for Eskom, by 2022/23. This target is expected to result in debt stabilising by 2025/26. This will require reductions to wage bill growth. Tax measures are also being considered

4

Supporting Eskom

- To mitigate the immediate risk that Eskom poses to the economy, the utility receives assistance to service its debt obligations. Addressing Eskom's underlying problems requires reinvigorated governance, operational efficiencies and restructuring

5

Short- and medium-term reforms

- Short- and medium-term reforms are urgently required to improve economic performance over the next several years. The discussion document released by the NT in August 2019 put forward an approach to restore growth momentum

6

Key Fiscal risks

- Key fiscal risks in the period ahead include weaker economic growth, uncertainty in the revenue outlook and a worsening of Eskom's financial and operational position



End



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