Box 4 The *2017 Medium Term Budget Policy Statement*[1]

Government's measured fiscal consolidation, as pronounced in the 2017 budget, is being threatened by slow domestic economic growth and concomitant large revenue shortfalls. The latter have contributed to a significant deterioration in the fiscal position since the February 2017 budget. The revenue shortfalls contributed to the fiscal deficit which, together with government debt, continues to increase relative to gross domestic product (GDP), as economic growth remains weak.

The impact of slower domestic economic growth on fiscal consolidation is expected to persist, as reflected by the downward revision of annual growth in real GDP to only 0.7% in 2017 from an originally estimated 1.3%, followed by a slow recovery to 1.9% in 2020.

Macroeconomic projections*

Percentage

	2016			2017		2018		2019		2020
				Medium-term estimates						
	Budget	MTBPS	Outcome	Budget	MTBPS	Budget	MTBPS	Budget	MTBPS	MTBPS
Real GDP growth	0.9	0.5	0.3	1.3	0.7	2.0	1.1	2.2	1.5	1.9
CPI	6.8	6.4	6.3	6.4	5.4	5.7	5.2	5.6	5.5	5.5
Current account balance (as a percentage of GDP)	-4.0	-3.9	-3.3	-3.9	-2.3	-3.7	-2.6	-3.8	-2.9	-3.1
GDP at current prices (R billions)	4 306	4 300	4 339	4 658	4 602	5 030	4 889	5 441	5 222	5 612

* February *2017 Budget Review* and October *2017 MTBPS* (calendar years)

Source: National Treasury

Although partly a consequence of weak economic activity, both the outlook for consumer price inflation and the deficit on the current account of the balance of payments (due to lower imports) as a ratio of GDP were expected to improve over the medium term compared to previous estimates.

The significantly revised macroeconomic projections informed a review of the fiscal framework, reflective of the complex challenge to deal with the revenue shortfalls while containing borrowing. This will be partly offset by a budgeted reduction in the contingency reserve over the next three years and the disposal of a portion of government's Telkom shares to prevent a breach of the expenditure ceiling. More specific and detailed measures to reduce spending and raise revenue are expected to be announced in the *2018 Budget Review.* The original and revised fiscal projections are summarised in the accompanying table.

The *2017 MTBPS* projected a consolidated government revenue shortfall of R50.8 billion compared to the February 2017 budget estimate for fiscal 2017/18 as a whole – the largest expected revenue under-collection since 2009. The shortfall could be attributed to slowdowns in all the main tax components (i.e. personal and corporate income tax, value-added tax (VAT) and customs duties).

1 The *Medium Term Budget Policy Statement (MTBPS)* was presented to Parliament by the Minister of Finance on 25 October 2017.

Fiscal framework*

R billions/percentage of GDP

	2016/17			2017/18		2018/19		2019/20		2020/21
				Medium-term estimates						
	Budget	*MTBPS*	Outcome	Budget	*MTBPS*	Budget	*MTBPS*	Budget	*MTBPS*	*MTBPS*
Total consolidated revenue	1 324	1 301	1 298	1 414	1 364	1 535	1 478	1 669	1 594	1 709
Personal income tax....	441	429	425	482	461	527	500	582	545	596
Corporate income tax .	198	201	204	219	214	233	224	252	236	251
Value-added tax (VAT) .	301	293	289	313	301	338	325	365	352	383
Total consolidated expenditure	1 463	1 452	1 446	1 563	1 567	1 677	1 671	1 814	1 802	1 935
Compensation............	517	515	510	550	549	589	588	631	630	678
Goods and services	205	205	208	222	220	237	236	254	256	270
Grants, transfers and subsidies....................	476	470	473	509	505	544	543	590	585	627
Debt-service cost........	148	148	147	162	163	181	183	197	203	223
Consolidated Budget deficit (fiscal balance).....	-139.0	-150.5	-147.5	-149.0	-203.0	-141.9	-193.1	-145.8	-208.1	-225.8
Percentage of GDP	-3.2%	-3.4%	-3.3%	-3.1%	-4.3%	-2.8%	-3.9%	-2.6%	-3.9%	-3.9%
Primary balance (national government)	-8.6	17.3	-21.3	-4.4	-56.3	9.5	-39.0	16.6	-39.8	-42.0
Percentage of GDP	-0.2%	-0.4%	-0.5%	-0.1%	-1.2%	0.2%	-0.8%	0.3%	-0.7%	-0.7%
Gross loan debt (national government)	2 233	2 246	2 478	2 478	2 531	2 713	2 830	2 905	3 094	3 416
Percentage of GDP	50.9%	51.3%	52.3%	52.3%	54.2%	52.9%	57.0%	52.4%	58.2%	59.7%
Net loan debt (national government)	2 003	2 004	2 226	2 226	2 294	2 442	2 569	2 670	2 864	3 179
Percentage of GDP	45.7%	45.8%	47.0%	47.0%	49.1%	47.6%	51.7%	48.1%	53.9%	55.6%

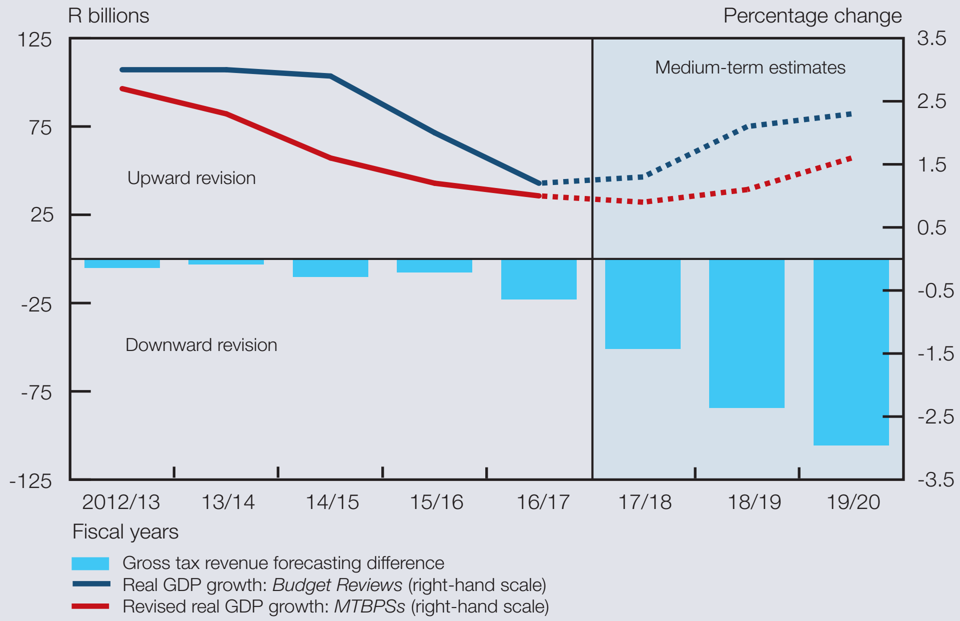
* February *2017 Budget Review* and October *2017 MTBPS* (fiscal years)

Source: National Treasury

Disconcertingly, the revenue shortfalls are expected to extend to the outer years, with gross tax revenue projected to fall short of the 2017 budget estimates by R84.3 billion in 2018/19 and by R106 billion in 2019/20. This mostly reflects weaker economic growth projections and a decline in tax buoyancy due to a change in the relationship between revenue and economic growth. The current and expected weak revenue collections are exacerbated by a number of economic factors, including slower output growth in key sectors that have supported buoyant revenue collection such as finance, retail trade and telecommunications; the moderation in wage settlement rates; slower growth in aggregate household income due to job losses; weak household consumption that negatively affects VAT collections; and the notable slowdown in the growth rate of imported goods.

Consolidated government expenditure was revised slightly upwards to R1 567 billion for fiscal 2017/18 in the *2017 MTBPS*. Expenditure related to the recapitalisation of South African Airways and the South African Post Office put the expenditure ceiling at risk of a breach of R3.9 billion.

Gross tax revenue and GDP forecasting differences*

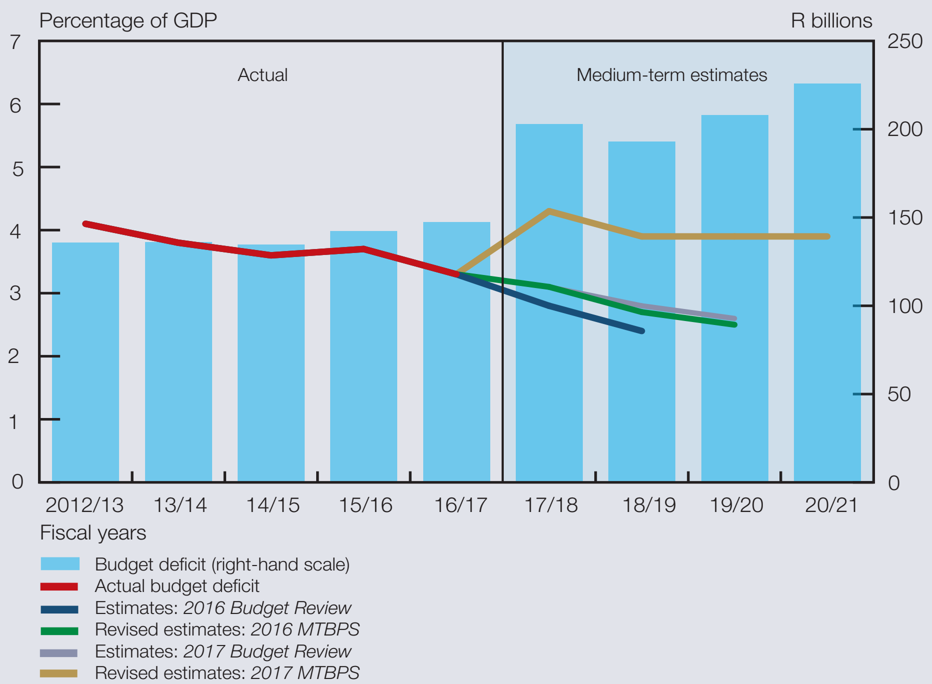


* Calculated as the difference between original estimates in the *Budget Review* and the revised estimates in the *MTBPS*

Source: National Treasury

The revenue shortfall and the upward revision in expenditure resulted in a much wider consolidated government budget deficit of 4.3% of GDP in fiscal 2017/18 – up from 3.1% in the February 2017 budget. The consolidated budget deficit was estimated to remain stable at 3.9% of GDP over the medium term, compared with the gradual improvement expected in the February 2017 budget. The main national government budget deficit was expected to stabilise at a higher 4.6% of GDP over the same period. Whereas the February 2017 budget envisaged a primary surplus over the medium term, the *2017 MTBPS* expected the primary deficit to widen in fiscal 2017/18 and to narrow only marginally over the medium term.

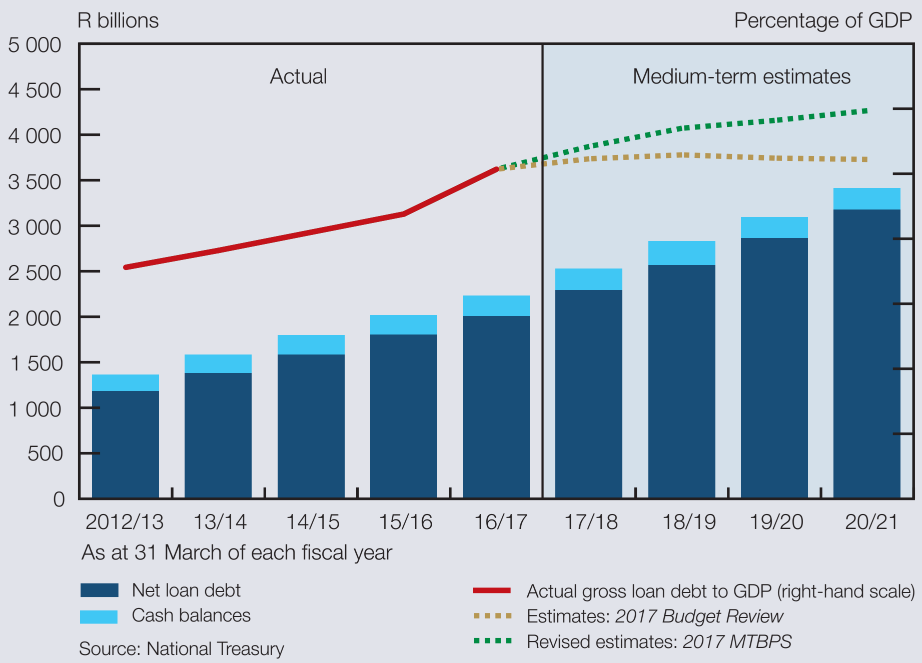
Consolidated government budget deficit



Source: National Treasury

The higher consolidated government budget deficit envisaged by the *2017 MTBPS* resulted in much higher projections of government debt. Total gross loan debt of national government has been revised higher by R53.0 billion to R2 531 billion (54.2% of GDP) at the end of fiscal 2017/18, and was expected to reach almost 60% of GDP in fiscal 2020/21, with debt-service costs approaching 15% of the main budget revenue. In the absence of higher economic growth or additional steps to narrow the budget deficit, the debt-to-GDP ratio is not projected to stabilise over the medium term. Total net loan debt of national government (gross loan debt minus cash balances) was estimated at R3.2 trillion, or 55.6% of GDP, in fiscal 2020/21.

National government debt



Source: National Treasury

Risks to the already weak fiscal position depicted by the *2017 MTBPS* remain elevated. These risks include increased financial demands from state-owned companies, pressures related to public servant compensation and new spending commitments associated with higher education. In the absence of an acceleration in real economic growth, government debt seems to be steadily approaching the International Monetary Fund's Debt Sustainability Assessment high-risk benchmark. In light of the deteriorating fiscal position, a team of Cabinet ministers that reports directly to the President would consider a range of proposals to return South Africa's public finances onto a sustainable path.